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Politics this week

Nov 24th 2005
From The Economist print edition

Sharon moves forward

Ariel Sharon, **Israel's** prime minister, broke away from his ruling Likud party to found the Kadima ("Forward") party, prompting a general election, in March. He probably nursed hopes of teaming up with the Labour Party in a new governing coalition. See article

A gathering of **Iraqis** in Cairo, including Iraq's president and representatives of the disaffected Sunni Arab community, called for Arabs in the region to support Iraq's emerging new order but also demanded a timetable for American troops to go. See article

Two weeks after the bombing of three hotels in Amman, **Jordan's** capital, King Abdullah named Marouf Bakheet, his country's security chief, as the new prime minister.

During the second of three rounds of voting in a general election in **Egypt**, widespread clashes between supporters of the ruling party and the officially unrecognised Muslim Brotherhood left one person dead and scores injured.

Kenyans rejected a new constitution put to a referendum by President Mwai Kibaki. The 57-43% vote reflected tribal divisions, with Mr Kibaki's Kikuyu, Kenya's biggest group, saying yes and most of the other main tribes saying no. See article

Ellen Johnson-Sirleaf was officially declared the winner of **Liberia's** presidential election, and will become Africa's first elected female head of state.

Reuters

Deepening divisions

Both George Bush and Dick Cheney distanced themselves from comments made by some Republicans last week accusing **John Murtha**, a Democratic congressional hawk and Vietnam veteran, of being unpatriotic for changing his stance on Iraq by calling for the withdrawal of troops. The accusations caused uproar in Congress and added fire to the political storm about the war. See article

The Justice Department indicted **José Padilla**, an American citizen who has been held without charge for three years as a suspected enemy combatant. The indictment alleges that Mr Padilla was involved in terrorist funding and financing, but no mention was made of the alleged "dirty bomb" plot for which he was originally held.

Patrick Fitzgerald, the special prosecutor investigating the leaking of a **CIA officer's** name to the press, said he would present new evidence to a second grand jury (the first grand jury brought charges against Mr Cheney's chief of staff). This comes shortly after Mr Fitzgerald questioned Bob

Woodward, one of America's best-known journalists, about his recollection of events.

Sins of the past

The geriatric former Chilean dictator, **Augusto Pinochet**, was placed under house arrest after being charged with tax evasion, passport fraud and use of forged government documents. The charges relate to $27m allegedly hidden in secret overseas bank accounts under false names.

A Canadian government-commissioned report on the 1985 bombing of an **Air India flight** from Toronto to Dehli that killed 329 people off the Irish coast called for a further public inquiry into the incident, which remains unsolved. The acquittal in March of two Sikh activists accused of organising the attack caused a public uproar after it transpired that vital evidence had been destroyed by Canada's intelligence services.

At least 34 people were killed in Honduras after **Tropical Storm Gamma** hit Central America last weekend. More are feared buried under mudslides in remote regions. Gamma is the 24th Atlantic storm this season—the busiest on record. Last month, Hurricane Stan killed up to 2,000 in Central America.

Arriving hordes

Reuters

George Bush became the first American president to visit **Mongolia,** stopping briefly in the vast country and marking the end of his week-long Asian tour. Surrounded by men dressed in Ghengis Khan-style uniforms, Mr Bush thanked Mongolia for sending some 100 troops to Iraq, and also asked after the health of a horse given to his defence secretary, Donald Rumsfeld, on his recent visit there.

Maoist rebels and seven democratic parties in **Nepal** made a deal to work to end the absolute rule of King Gyanendra and introduce democracy. The king seized power in February, saying Nepal's politicians were unable to end the rebels' bloody insurgency. See article

Businesses and schools closed in the city of Harbin, in **China,** when officials admitted that the water supply had been poisoned by benzene after an explosion at a petrochemical plant higher up the Songhua river, which supplies the city's 3m people.

Japan's ruling Liberal Democratic Party drafted a change to the country's constitution that allows Japanese troops to play a wider role in global peacekeeping operations. The document was formally presented to a convention marking the 50th anniversary of the party's founding.

A German first

Angela Merkel was sworn in as Germany's first female chancellor and promptly made quick visits to Paris, Brussels and London to stress her European credentials. She also reiterated her desire to mend relations with America, which became somewhat strained under her predecessor, Gerhard Schröder.

Russia's Duma backed a draft law that curbs the activities of foreign NGOs. Pro-democracy and

human-rights groups, which have flourished since the fall of communism, gave warning that the bill will lead to increased state supervision. President Vladimir Putin has previously scolded NGOs and hinted that they are being used by other countries to interfere in Russia's politics.

Ten years after the Dayton peace agreement that ended **Bosnia's** civil war, the leaders of the country's three main ethnic groups—Muslims, Serbs and Croats—agreed to a package of constitutional reforms at a meeting in Washington, DC. However, Condoleezza Rice, America's secretary of state, told them there could be “no more excuses and no more delays” in arresting and bringing to justice those accused of war crimes. See article

New **licensing laws** came into effect in England and Wales that liberalise the sale of alcohol and allow pubs to extend their opening hours. The legislation has caused some bother for the government as opponents claim the new regime will cause a spike in the popular British leisure pursuit of “binge drinking”. See article

Reuters

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Business this week

Nov 24th 2005
From The Economist print edition

The X-factor

Microsoft released the **Xbox 360** in North America. It was immediately snapped up by gamers who had queued for hours to buy the first "next generation" video-game console. Microsoft trails Sony and is a close rival to Nintendo in the console market, but the early release of the Xbox 360 may help to address that—its rival consoles will not be released until next year. See article

Texas brought a civil lawsuit against **Sony** BMG claiming that copyright-protection software it had included in its bestselling music CDs posed a security risk to computers. Sony recently had to recall some 5m CDs that use XCP technology, which prevents the multiple copying of a CD, because it could leave a PC open to hackers.

Cisco Systems agreed to buy **Scientific-Atlanta**, which specialises in cable-TV technology, for $6.9 billion. The deal, which was challenged by some of Scientific-Atlanta's shareholders, is designed to put Cisco in prime position to take advantage of an expected surge in demand for digital TV and communications. See article

Wagoner's wheels in motion

General Motors unveiled a restructuring plan for its North American operations that will close nine plants and three related facilities with the loss of 30,000 jobs (of which 25,000 had already been announced in June). The carmaker, which made a loss of $3.8 billion in the first nine months of this year, expects to save around $7 billion by the end of 2006.

Talks aimed at liberalising the transatlantic airline market paved the way for a breakthrough **"open skies"** agreement to allow American and European carriers unrestricted access between the two continents. However, the deal must be ratified by all 25 EU states and will be in trouble if Congress muscles in on a proposal to give foreign investors a bigger say in the operations of American airlines. See article

The New York Stock Exchange ruled that the proposed acquisition of a 19.8% stake in **Sovereign Bancorp** by **Banco Santander Central Hispano** did not need the approval of Sovereign's shareholders. The decision was greeted with derision by dissident Sovereign investors, who insist BSCH is underpaying with its offer, which gives Spain's biggest bank the option of eventually buying Sovereign outright.

Regulators in Britain told **Macquarie Bank** that if it did not state its firm intention to bid for the **London Stock Exchange** by December 15th it would be banned from doing so for six months. The Australian bank is interested in the exchange, but is having difficulty finding a partner for its offer. Speculation over other potential bids has pushed up the LSE's share price by 70% since September 2004.

Analysts gave mixed reviews to **Swiss Re's** proposed acquisition of **General Electric's** insurance arm. The $6.8 billion deal, announced last week, catapults the Swiss firm in front of Munich Re, its German rival, as the world's biggest reinsurer. But concerns were raised that buying General Electric Insurance Solutions could expose Swiss Re to too much risk. See article

Observers of America's Federal Reserve picked over the minutes of November's Federal Open Market Committee meeting and predicted that the central bank will soon end its cycle of **interest-rate** rises. Meanwhile, the European Central Bank gave its strongest hint yet that on December 1st it will raise its interest rate for the first time in five years.

Share prices can go down

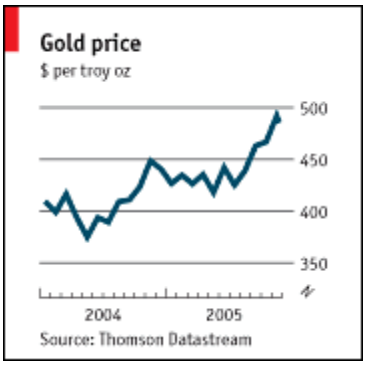
Electricité de France made its stockmarket debut. The sale of a 15% stake in the state utility raised €7 billion ($8.3 billion), making it the world's biggest IPO since 2001 (and the biggest-ever on the Paris bourse). However, EDF's share price closed at €32, the discounted price at which it was offered to 5m investors, disappointing those hoping for a quick profit.

E.ON abandoned its bid to buy **Scottish Power**, valued at £11.3 billion ($19.4 billion). The German utility group had raised the offer from its initial bid in September, but Scottish Power, which saw its share price fall after E.ON's decision, maintains the deal does not offer value to shareholders.

Arcelor, the world's second-largest steelmaker, launched a $3.8 billion hostile bid to buy **Dofasco**, Canada's biggest steelmaker. The deal could give the Luxembourg-based firm a foothold in North America and provide consolation for losing a recent auction for Kryvorizhstal, Ukraine's state-owned steel company.

Just in time for Christmas

Gold prices rose to an 18-year high on November 22nd before falling back slightly as investors cashed in. There was much speculation that the metal would soon break the $500-an-ounce barrier, but many analysts think rising interest rates will push investors into higher-yielding assets.



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Economist.com OPINION

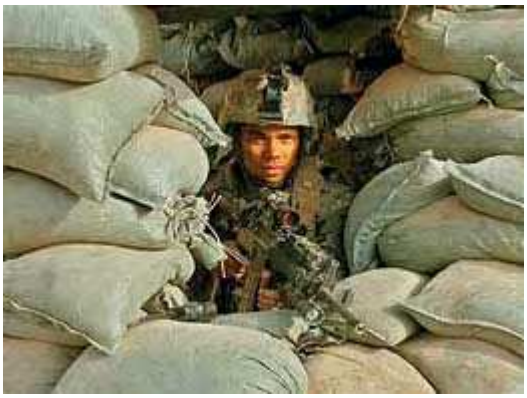
America and Iraq

Why America must stay

Nov 24th 2005
From The Economist print edition

America should keep its troops in Iraq until Iraqis ask them to go

AFP



WARS waged abroad are often lost at home; and that may be starting to happen with Iraq. Calls for American troops to withdraw are familiar in the Arab world and Europe, but in the United States itself such talk has remained on the fringes of political debate. Now, with surprising suddenness, it has landed at the centre of American politics.

On November 17th John Murtha, a hawkish Democratic congressman, suggested pulling the troops out of Iraq in six months, prompting an unseemly spat between the former marine colonel and the White House. Moves to set a timetable have been voted down, but the Republican-controlled Senate has voted 79-19 for 2006 to be “a period of significant transition to full Iraq sovereignty” and the Pentagon is mumbling about troop reductions. Meanwhile, some hundred Iraqi leaders at a reconciliation conference in Cairo backed by the Arab League talked about setting a timetable for withdrawal.

There is some politicking in this. In Cairo, the Shias and Kurds, who dominate Iraq's new order, were offering an olive branch to the sullen Sunnis, who used to run the show under Saddam Hussein. In America, Republicans are looking nervously at the 2006 elections. Democrats sense that George Bush is vulnerable—and that Iraq presents the best way to hurt him now that most Americans regret invading the country. Yet there is plainly principle too: Mr Murtha and millions of others maintain that America is doing more harm than good in Iraq, and that the troops should therefore come home.

This newspaper strongly disagrees. In our opinion it would be disastrous for America to retreat hastily from Iraq. Yet it is also well past time for George Bush to spell out to the American people much more clearly and honestly than he has hitherto done why their sons and daughters fighting in Iraq should remain in harm's way.

The cost of failure

Every reasonable person should be able to agree on two things about America's presence in Iraq. First, if the Iraqi government formally asks the troops to leave, they should do so. Second, the argument about whether America should quit Iraq is not the same as the one about whether it should have gone there in the first place. It must be about the future.

That said, the catalogue of failures thus far does raise serious questions about the administration's

ability to make Iraq work—ever. Mr Bush's team mis-sold the war, neglected post-invasion planning, has never committed enough troops to the task and has taken a cavalier attitude to human rights. Abu Ghraib, a place of unspeakable suffering under Mr Hussein, will go into the history books as a symbol of American shame. The awful irony is that the specious link which the administration claimed existed between Iraq and al-Qaeda in order to justify going to war now exists.

Two-and-a-half years after Mr Bush stood beneath a banner proclaiming “Mission Accomplished”, the insurgency is as strong as ever. More than 2,000 Americans, some 3,600 Iraqi troops, perhaps 30,000 Iraqi civilians and an unknown number of Iraqi insurgents have lost their lives, and conditions of life for the “liberated” remain woeful. All this makes Mr Bush's refusal to sack the people responsible for this mess, especially his defence secretary, Donald Rumsfeld, alarming.

But disappointment, even on this scale, does not justify a precipitate withdrawal. There are strong positive and negative reasons for America to see through what it started.

Flickers of hope

Iraq is not Vietnam. Most Iraqis share America's aims: the Shia Arabs and Kurds make up some 80% of the population, while the insurgents operate mainly in four of Iraq's 18 provinces. After boycotting the first general election in January, more Sunni Arabs are taking part in peaceful politics. Many voted in last month's referendum that endorsed a new constitution; more should be drawn into next month's election, enabling a more representative government to emerge. That will not stop the insurgency, but may lessen its intensity. It seems, too, that the Arab world may be turning against the more extreme part of the insurgency—the jihadists led by al-Qaeda's leader in Iraq, Abu Musab al-Zarqawi, who blow up mosques around Baghdad and Palestinian wedding parties in Jordan (see article). Though few Arabs publicly admit it, Mr Bush's efforts to spread democracy in the region are starting to bear fruit.

So America does have something to defend in Iraq. Which, for Mr Bush's critics, leads into the most tempting part of Mr Murtha's argument: that American troops are now a barrier to further progress; that if they left, Mr Zarqawi would lose the one thing that unites the Sunnis and jihadists; and that, in consequence, Iraqis would have to look after their own security. This has a seductive logic, but flies in the face of the evidence. Most of the insurgents' victims are Iraqis, not American soldiers. There are still too few American troops, not too many. And the Iraqi forces that America is training are not yet ready to stand on their own feet. By all means, hand over more duties to them, letting American and other coalition troops withdraw from the cities where they are most conspicuous and offensive to patriotic Iraqis. Over time, American numbers should fall. But that should happen because the Iraqis are getting stronger, not because the Americans are feeling weaker. Nor should a fixed timetable be set, for that would embolden the insurgents.

The cost to America of staying in Iraq may be high, but the cost of retreat would be higher. By fleeing, America would not buy itself peace. Mr Zarqawi and his fellow fanatics have promised to hound America around the globe. Driving America out of Iraq would grant militant Islam a huge victory. Arabs who want to modernise their region would know that they could not count on America to stand by its friends.

If such reasoning sounds negative—America must stay because the consequences of leaving would be too awful—treat that as a sad reflection of how Mr Bush's vision for the Middle East has soured. The road ahead looks bloody and costly. But this is not the time to retreat.

Economist.com OPINION

The Balkans, ten years on

Europe's banlieue

Nov 24th 2005
From The Economist print edition

Like France's troubled suburbs, the Balkan war zones cannot be sealed off—or safely ignored

THE Balkans, said Otto von Bismarck, are not worth the healthy bones of a single Pomeranian grenadier. A century and a quarter after that famous brush-off, Europe's richer, smugger parts are still tempted to turn their backs on their continent's most unstable and wildest corner.

To a European Union that views itself as part of the world's elite—a huge, if rather sluggish, economic power that can be rather choosy about who it deals with—its squalid Balkan backyard is an embarrassment. Indeed, there are questions about whether it is part of Europe at all. Serious politicians in France, Germany and Austria were saying, only a decade ago, that countries with an Ottoman or Byzantine heritage—such as Romania, Bulgaria and most of ex-Yugoslavia—weren't really heirs to the glories of European civilisation.

If west Europeans feels uneasy about the Balkans, that is partly because of the blunders they have made. For all his detachment, Bismarck was a master of Balkan diplomacy, but modern Europe has lacked his touch. When old Yugoslavia broke up, it was initially seen, absurdly, as a little local difficulty which Europe could handle with no help from anyone else. Then, when the horrors began, they were dismissed as too intractable to stop.

In fact, as became clear in the final chapters of the conflicts in Bosnia—which ended in a peace agreement exactly a decade ago—and then Kosovo, Balkan wars are as easy to control as people want them to be; but they stop only when America and all the main European powers act together, instead of scoring points off one another. Now, the Balkan guns have mostly fallen silent, and the region and its queasy European friends are at another crossroads (see article). In a year's time, Kosovo may be independent. Bosnia is gradually turning into a functioning state. Montenegro may vote in a referendum to break with Serbia. The accord that saved Macedonia from civil war seems to be holding. An era of intensive care, in which Kosovo was run by Finns or Danes, and Bosnia by Austrians and Brits, may be ending.

So what does rich Europe do now? For a half-exhausted, introverted EU with many problems nearer home to worry about, it is tempting to walk away altogether, at least from the places which seem incorrigible. The Union has proved good at teaching governance to countries like Bulgaria and Romania where politicians want to learn and will get a nice prize—early membership—in return. Among the six republics of old Yugoslavia, there is only one European super-star, Slovenia; and Croatia is back on a European track after wobbling off it.

But as for the other countries of the region—all scarred by war, anarchy or criminal nationalism—a sceptic could make a decent case for writing them off. In Albania and much of ex-Yugoslavia, the

forces ranged against the state—crime syndicates and armed nationalists—are often more than a match for legitimate business and politics. Government, in so far as its writ runs at all, is frequently worse than useless: customs barriers and regulations simply obstruct legal business, offer bribe opportunities for bureaucrats and abet crime.

Given that the total population of the Balkans' most problematic parts is barely 20m, and their per head income is barely a fifth of the EU average, why not just quarantine them until they start behaving like potential members of a rich, respectable club? That, in a way, is what Europe managed to do during Bosnia's horrors: the Vienna stock exchange hardly flickered as massacres occurred a couple of hours' drive away.

To find out why that is not an option, ask the British police who, with help from the UN police in Kosovo and several other countries, have just cracked a people-smuggling ring that originated in Turkey and may have spirited as many as 200,000 desperate folk (mostly from eastern Turkey) into the Union's richer places. Or consult a report by Europol, the European police agency, which has traced the activities of Balkan-based crime syndicates. Albanian gangs spirit people into Britain and Germany; guns are reaching Britain from Croatia and points south; the stolen-vehicle trade in the Netherlands is dominated by Serbs; and Chinese syndicates based in ex-Yugoslavia send illegal migrants to Finland. It was once said of the Balkans that they produce more history than can be consumed locally; it is even more true that the region is a big net exporter of crime.

Hard as things are now, they would be worse if rich Europeans tried—and inevitably failed—to seal the Balkans off. The less access the people of south-eastern Europe have to EU markets for goods and labour, the easier it will be for organised crime to tighten its grip on the region and spread mayhem elsewhere. Especially in places like Kosovo where the population is rising fast and underemployed, there is huge unspent energy which will find malign outlets unless a healthy, outward-looking economy can put idle hands to work. Putting a wall round the Balkans will have the opposite effect.

In need of a better future to bury the past

That is one reason why Europe's fate is intertwined with the Balkans. Rich Europeans cannot ignore the region, any more than wealthy citizens of France (or any other European country) can shrug off the problems of compatriots whose poverty and alien speech or faith makes them awkward neighbours.

Another reason to avoid a massive turning of backs on the Balkans is that events there can have repercussions in unexpected places, in part because of religious solidarity. Neither the French riots nor the Balkan wars were mainly the result of clashing faiths. But in this ultra-sensitive area, actions (or non-actions) by European governments send ripples round the world. Just as French mishandling of immigrant youths reverberates in Jakarta and Algiers, so the fate of Bosnia's Muslims caused rage in Malaysia and Pakistan. The effects of any new failures in the Balkans will be felt well beyond the region.

Like it or not, west Europeans must remain engaged in their squalid south-east, offering advice, money and the ultimate prize of admission to the EU club. Otherwise the woes of the Balkans will come to them, just as the French slum-dwellers have rattled nerves in the smart districts of Paris.

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Economist.com OPINION

Israel

The surprising Mr Sharon

Nov 24th 2005
From The Economist print edition

A long-time man of war might yet be the one to make peace

Reuters

THE bulldozer that is Ariel Sharon has knocked flat the party he was instrumental, 32 years ago, in building up and then turning into a machine that ran Israel with ruthless determination for all but ten of the ensuing years. Now, aged 77 but still unstoppable behind the wheel, he is set to roll over Israeli politics again. He has put himself at the head of a newly invented party in the centre of Israel's cluttered highway, far away from the point where he first roared in as the belligerent general who made his enemies, Israeli but especially Palestinian, quake with fear and hatred. Yet it may be Mr Sharon who can push to a lasting peace on that holy little patch of land whose disputed ownership has helped cause so much bloody enmity between the Muslim world and the West.

But before betting on Mr Sharon, in his new guise as man of peace, to shove Israel's voters in the right direction, remember that Israeli politics is exceptionally unpredictable. Great men of Israel, even its founding leader, David Ben-Gurion, have gone off to invent new parties of their own—and then fizzled. Mr Sharon, though still a popular leader of a deeply divided nation, could follow suit (see article). Thanks to his defection from the ruling Likud party, a general election is due in four months: in Israel's hectic circumstances, a long time. An upsurge of Palestinian terror, breaking today's fragile ceasefire, could bolster Likud and the residual rejectionist right, which sees no point in negotiating, let alone making further territorial concessions. A rejuvenated Labour Party under Amir Peretz, a new leader on the old left, might eclipse the old man. In any event, no single party will win an outright majority in parliament, so a variety of ruling combinations could emerge. But Mr Sharon has at least a good chance of heavily influencing—indeed leading—a government based on a coalition of Labour and his new party that would be far better able than the outgoing one to seek peace with the Palestinians anew.

In truth, Mr Sharon's eventual intentions are hard to fathom; he may not know himself. The bleak view of most Palestinians and many Israelis is that his apparent change is illusory, that his withdrawal of Israeli settlers and soldiers from Gaza was merely tactical, and that he has no wish to make the sort of territorial concession on the West Bank, the main part of a would-be Palestinian state, that would be minimally acceptable to any Palestinian leader. Instead, by this glum reading, Mr Sharon would sit tight, bottling the Palestinians up behind the barrier he has built to protect the three main Jewish settlement blocks entrenched by him on Palestinian land. If they rose up again in revolt, as they might well do, he would thump them as before, leaving them to their rage in a truncated patchwork of dismal walled-off cantons, forever. His past hints and record make this grim scenario plausible.

But could Mr Sharon truly change, with an eye to his place in history and Mr Peretz sharing power

and helping to pull him along? If the Palestinians, also facing a general election in January, were to constrain their own rejectionists and prove ready to accept something close to the West Bank deal President Clinton nearly got five years ago—with the barrier that is already a rough border between the two states to be adjusted in the Palestinians' favour by rerouting and land swaps at a later stage—might Mr Sharon drop his unilateral approach in favour of re-engagement with the Palestinians? And would that bring a lasting peace? A naive hope, perhaps. But the bulldozer never ceases to surprise.

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Microsoft

The meaning of Xbox

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From The Economist print edition

Does the launch of the Xbox 360 herald Microsoft's reinvention of itself?

AP

WHAT is the meaning of Xbox? Its name has horribly geeky origins: the bit of Microsoft's Windows software that does fancy graphics is called DirectX, so when the company moved into games consoles in 2001, it wanted a "DirectX box" that was optimised for graphical performance. But never mind the term's literal meaning. What does the glitzy launch this week of its successor, the Xbox 360, at a hangar in the Mojave Desert, tell us about the world's biggest software company? The answer comes in three levels.

First, the launch of the Xbox 360 is the most vivid illustration so far of Microsoft's advance into markets outside its original business of making software for desktop and server computers. Aside from gaming, Microsoft has been trying to get its software into mobile phones, set-top boxes and other non-PC devices for years. Only recently has it started to make any progress (see article). In gaming, Microsoft now represents the biggest threat to Sony's dominance of the industry: with the launch of the Xbox 360, the question is not whether Microsoft will eat into Sony's market share, but how much it will do so. In mobile phones, after a slow start, Microsoft is also making gains. Its software can be found in smartphones made by Motorola and others, and it now senses an opportunity to provide a low-cost, mass-market alternative to the BlackBerry. And as telecoms firms around the world prepare to start supplying television over broadband links, better to compete with cable operators, Microsoft has finally found some allies prepared to put its software into set-top boxes.

Second, the Xbox shows that Microsoft can be an innovative company when it has to. A good way to annoy Microsoft executives has always been to ask them to name some innovations that have come from the company's huge expenditure on research and development. Lots of features that are hidden under the hood, they would mumble—the Windows Media format is pretty clever—and wasn't the talking paper clip quite neat? But now, when asked, they can point to Microsoft's industry-leading Xbox Live service, which seamlessly links up gamers around the world for multiplayer fun, handles upgrade patches to games, and allows trailers, mini-games and new levels to be downloaded. If only PC networking was as effortless. According to Robbie Bach, Microsoft's "chief Xbox officer", "it demonstrates for people what we've been doing all along and people just haven't been able to see, which is the company is a fountain of innovation."

There is another explanation, of course. It is surely no coincidence that Microsoft's hidden ability to innovate has become apparent only in a market in which it is the underdog and faces fierce competition. Microsoft is far less innovative in its core businesses, in which it has a monopoly (in Windows) and a near monopoly (in Office). But in the new markets of gaming, mobile devices and television set-top boxes, Microsoft has been unable to exploit its Windows monopoly other than indirectly—it has financed the company's expensive forays into pastures new. Indeed, with mobile

phones and set-top boxes, Microsoft's reputation as a monopolist counted against it, and it was, in effect, frozen out for many years. So it has had to find other ways into those markets, including—shock, horror—innovation in both technology and marketing.

Microsoft's iPod moment?

So, finally, does the Xbox mean that Microsoft itself has changed? Does the device herald an Apple-style second act, in which a company that grew up in the personal-computer era reinvents itself as a sexy consumer-electronics firm? Certainly the Xbox does Microsoft's image no harm, but the answer is “no”. For even if the Xbox 360 exceeds expectations and dethrones Sony as ruler of the games industry, the resulting profits would still not hold a candle to those produced by Microsoft's core businesses: $20 billion last year, on revenues of $40 billion. For the foreseeable future, gaming, mobile phones and TV will be of marginal import for Microsoft's finances.

That said, last month Microsoft announced “Windows Live” and “Office Live”, which will be online-services versions of its two big software franchises. Today they are merely cosmetic rebrandings of Microsoft's existing offerings, but their names indicate that the cool and innovative Xbox Live is the model. So far, Microsoft has kept its Xbox division at a “skunk works”, at arm's length from the rest of the firm. But as it takes on internet-based foes such as Google and Salesforce.com, it will be interesting to see whether Microsoft can transplant some of its innovative gaming DNA into its main business.

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Economist.com OPINION

Monetary policy

Bratwurst and sushi

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Why Europe's monetary policy needs to tighten and Japan's doesn't

EUROPE'S interest rates, stuck at 2% for 30 months, have not increased in more than five years. So the signal last week by Jean-Claude Trichet, president of the European Central Bank, that rates would rise at the bank's meeting on December 1st was shocking, especially as many condemn any talk of dearer money as imprudent and premature.

Many European politicians argue that a rise in rates could snuff out the euro area's economic recovery. The region is at last perking up, with average growth in the third quarter of 2.6% at an annual rate, but consumer spending remains fragile. Indeed, some commentators fret that a rise in interest rates—especially when Germany plans to raise value-added tax—risks repeating Japan's past policy mistakes, and will tip the euro area back into recession. This is what happened when Japan increased its consumption tax in 1997 before recovery was firmly underway. Then in August 2000, after the economy appeared to be recovering, the Bank of Japan (BoJ) raised interest rates by a quarter point, only to be forced to reverse policy abruptly when the economy again buckled.

Will the same happen in Europe? Fashionable though it is to compare the euro zone to Japan, their economies are no more alike than bratwurst and sushi. The euro area's inflation is running at 2.5%; when the BoJ raised interest rates in 2000, Japan was suffering from deflation (it still is). Even with zero interest rates, Japan's real rates were already positive before the BoJ pushed them higher. In contrast, the euro area has enjoyed negative real interest rates for most of the past two and a half years. In sharp contrast to Japan in 2000, the euro area's monetary policy is unusually loose. After all, both the money supply and bank credit are growing at an annual pace of more than 8%. In Japan in 2000, bank lending was contracting, along with property prices, unlike in Europe today.

Lost in translation

The euro has weakened this year and long-term bond yields have fallen, creating even easier monetary conditions. This makes a nonsense of the argument that the ECB's policies are choking demand. Nor is the ECB obsessed with defeating inflation: in only nine months during the past five years has inflation been below the bank's 2% ceiling. It is true that the core rate of inflation (excluding food and energy) is only 1.5%. But it is the headline rate that influences inflationary expectations. Moreover, both inflation measures exclude the housing costs of owner-occupiers, a large slice of the cost of living. Add them in and inflation would be higher.

Today's interest rate was set in 2003 when the ECB was worried about the risk of deflation. The

risks now lie more on the upside. The neutral rate of interest (which neither stimulates nor restricts the economy) is around 4%, so a modest rise in rates would still leave policy expansionary—as it needs to be while there is still economic slack. But with stronger borrowing and demand, the ECB is right to want to nudge interest rates slowly back towards normal levels to prevent a build-up of excess liquidity, which could spur future inflation or asset-price bubbles. Relative to the strength of its economy, the ECB would indeed be starting to tighten policy sooner than America's Fed did when it first raised rates last year. But, arguably, the Fed left policy too loose for too long. By doing so, it inflated its housing bubble, which could pop next year with painful economic consequences.

If anybody needs to take heed of Japan's policy mistakes it is the Bank of Japan itself, which is also keen to end its zero-interest-rate policy. Japan's output has rebounded more strongly than that of the euro area over the past year, but prices are still falling, so growth in nominal GDP remains weaker. The official core rate of inflation could soon turn positive, but this measure includes oil prices which have risen sharply over the past year. Stripping out energy, Japan's inflation rate will stay negative for a while. The Bank of Japan should not even think about tightening policy until deflation is decisively beaten.

Japan has the highest real interest rates among the big three economies, the euro area the lowest. That is a good reason for different policy advice. Bratwurst and sushi don't mix.

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Economist.com OPINION

Pensions

65, not out

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Gordon Brown will do pensioners a disservice if he prevents reform

Getty Images

TURNER is in trouble. The government-appointed Pensions Commission chaired by Lord Turner is due to propose on November 30th the most sweeping reform of ageing Britain's pension system since it was set up in 1946. It seemed that everyone, from the left to the right of the political spectrum, favoured his broad approach: increasing the basic state pension and raising the retirement age to help pay for it. The consensus, however, left out the single most important player: Gordon Brown, chancellor of the exchequer and prime minister-in-waiting.

The commission is expected to make three main recommendations to deal with a pension system that will not provide a decent old age for Britain's retiring millions. First, it will seek to raise the state-pension age (now 65 for men and 60 for women) to 67 for everyone after 2020, and beyond that in line with fast-rising life expectancy. It will also propose a new national retirement-savings plan, in which new employees will automatically be enrolled. This is intended to boost savings without actually forcing people to stash their money away. Third, it will try to prevent the system from discouraging saving. At present, the government's pension-credit scheme, which Mr Brown introduced in 2003, boosts the incomes of poorer pensioners but penalises the savers among them for their thrift.

All well and good, one might think—but the Treasury apparently doesn't agree. Mr Brown is worried that the whole thing will cost too much. Despite the rapid increase in pensioner numbers, the Treasury plans to keep pension spending under control by targeting resources on poorer retirees through the pension-credit scheme, and letting the basic state pension, which all retired people receive, gradually erode in value relative to wages. The key to this strategy is maintaining the link between the basic state pension and prices, and between pension credits for poorer folk and earnings. Earnings rise faster than prices.

Mr Brown is clearly right to worry about the cost of these proposals. The trouble is that the Treasury's approach is widely seen as lacking credibility. British pension arrangements have relied in the past on a partnership between private-sector employers and the state. As companies faced with ballooning deficits stop offering pensions, individuals have to save more themselves. But the badly designed pension credits discourage them from doing that.

There is also an element of *amour propre* here. The pension-credit scheme is Mr Brown's pet project. He has seemingly been stung by comments in the commission's interim report criticising the disincentive to saving that it creates. He also reckons that Lord Turner has exceeded his brief, which was to look at private pensions. And he is sceptical that raising the retirement age will save much money.

Brown the dissenter

Mr Brown's hostility could sink the commission's recommendations. Despite the broad welcome that Lord Turner can expect in most quarters, the Treasury has an effective veto over implementing its proposals. The likelihood that Mr Brown will be the next prime minister adds to the Treasury's clout. It will be a pity if his opposition scuppers the proposals. One reason why pensions are in such a mess in Britain, as elsewhere, is that they have too often been determined by the dictates of short-term politics. That's what happened last month, when the government, threatened with strikes, funked the decision to raise the retirement age for public-sector workers in line with the private sector. Lord Turner's report offers a rare chance to break with this lamentable tradition.

As John Hutton, the pensions minister, pointed out on November 24th, the goal is to come up with a solution that is simple, sustainable and affordable. The key to sustainability is that everyone, from all political walks of life, signs up to it—including Mr Brown. One of his favourite themes is the need to forge a “progressive consensus”; yet, on pensions, his is the loudest dissenting voice.

Ironically, there are signs that the Conservative Party under David Cameron, their likely new leader, may be ready to join the consensus on this issue. Mr Cameron has indicated that he will eschew political opportunism and support government policies which he believes to be sensible on their merits. Next week's publication of the Turner Commission's suggestions will provide both leaders-in-waiting with a chance to show that they mean what they say.

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On the riots in France, Peru and Chile, Brazil, oil, Chinese history, baptisms, cookery

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From The Economist print edition

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The roots of discord

SIR – Having lived in a third-world country (Russia) whose inhabitants have far less opportunity and suffer much more injustice than the rioters in France, I find it quite dismaying that you could equate criminal violence with an underclass revolt ("An underclass rebellion", November 12th). This is an insult to those people who are poorer, yet do not use their plight to justify criminal activity. The real victims of the riots in France were the decent Muslim immigrants, and their descendants, who were powerless against the criminals and had to watch their already impoverished surroundings become even more so. Get out of your comfortable offices and come and live in the immigrant areas of Paris or Berlin, where a tiny portion of the population (consisting primarily of young immigrant males) makes life miserable for everyone.

Terry Taylor
Berlin

SIR – You said that a policing policy of "zero tolerance" was one factor that turned a "general malaise into chronic violence". If such a policy means not letting even small delinquencies such as spraying graffiti that defaces public property go unpunished, then it has never been adopted, never mind enforced, in France. Violence and theft have been endemic in the *banlieues* for more than 20 years and the police have kept out of these "no law zones". Buildings have been severely damaged, cars stolen and torched (by the thousands each year), firemen stoned, shops looted, doctors molested, and all the while drug traffickers go about their business in full daylight.

Florin Aftalion
Paris

SIR – The riots were an expression of anger and deep-rooted unrest and a response to a tough policing policy. I am a middle-class white youth from Toulouse, yet I too feel some of the anger and restlessness that some of my peers have felt. Our society proudly proclaims that we are all equal, free and French, yet we've seen the rise of racist politicians who want to throw immigrants out of France and restore the death penalty.

Alexandre Tsihlas
Oxford

Defining the boundaries

SIR – You state that recent tensions between Peru and Chile have been "triggered by Peru's recent approval of a law to modify the countries' maritime boundary unilaterally, to claim some rich

fishing grounds" ("An unwelcome visitor", November 12th). The approval of a base-line law (a line drawn by countries along their coasts to measure the breadth of their sea) is a practice carried out by almost every state in the world and in no way signifies the unilateral establishment of maritime boundaries with Chile. Since the current fishing agreements between Peru and Chile cannot be upgraded to the category of maritime boundary treaties, Peru proposed negotiations to determine these boundaries, which were not accepted. The refusal of Chile to agree to the negotiations has exhausted the possibility of finding a bilateral solution, leaving Peru the option of peacefully settling the dispute by other means as set out in international law.

Luis Solari Tudela
Ambassador for Peru
London

Fertile soil?

SIR – Your report on farming in Brazil is correct to point out that the country's agriculture industry can still expand, without impinging on the Amazon rainforest, by further developing the *cerrado* savannah ("The harnessing of nature's bounty", November 5th). However, you omitted to mention that the *cerrado* is already suffering from falling groundwater levels, soil degradation and staggering losses in its own biodiversity. And with the land being so cheap, who would want to invest in long-term soil management there? You painted an interesting picture of an "endless" Brazilian farm, but why was there no room to depict small farmers, wildlife and viable ecosystems?

Franz Meyer
Hamburg, Germany

Subsidising the oil giants

SIR – Rather than imposing a windfall tax on the record "excess" profits of oil companies, the real concern for Americans should be why their government gave the oil industry billions of dollars in tax breaks ("An oily slope", November 5th). The proper way to deal with these profits would be to repeal the energy bill and its inherent free money: it is obviously easier for politicians to point fingers at the oil industry than admit they were wrong.

Dylan Wells
San Francisco

Chinese treasures

SIR – Your review of the Royal Academy's exhibition of Chinese art from the Qing period quotes Dame Jessica Rawson as saying: "The past is a valuable part of the present in China" ("Qing bling", November 5th). One wonders if President Hu Jintao, when cutting the ribbon at the exhibition with Tony Blair, reflected on the past and remembered that during the second opium war in 1860 troops under Lord Elgin (son of Lord Elgin of the Parthenon marbles) looted and then destroyed the fabled Summer Palace, which had been developed by the Qing emperor Qianlong.

Robin Chiang
San Francisco

Baptisms in Texas

SIR – It is insulting and misleading to equate a Baptist church, which I used to attend, in Waco,

Texas, with David Koresh and the Branch Davidians or any other extremist religion in Texas ("The faithful on the front-line", November 5th). I am also appalled at your allegation that baptisms are a life-threatening ritual. Growing up a Baptist (I am no longer affiliated), I can attest that the practice of baptism by immersion in water is not dangerous but rather a beautiful profession of one's faith.

Jeremy Black
New York

SIR – It would have been more informative to draw your readers' attention to the more deadly conditions of Christian churches in China, India and Sudan (to name but a few) over the past decade as opposed to drawing some dubious conclusion from disparate events in Texas. I failed to see the point of your article.

Neil Burleson
Goroka, Papua New Guinea

SIR – Your sarcastic references to the death of Kyle Lake, a pastor who accidentally electrocuted himself during a baptism, were disturbing and served no purpose other than to ridicule a man who died practising his religion. Most disgusting, however, is your subtitle: "Surely not what the Good Lord intended". I cherish *The Economist* for its economic and public policy insight, but am dumbfounded by your decision to pass such religious judgment.

Bobby Wehmeyer
Ann Arbor, Michigan

Roll over Mrs Beeton

SIR – It was indeed a revelation to learn that half of the most popular cookbooks sold worldwide are inspired by British cuisine ("Books for cooks", November 5th). But isn't it sad that very few Britons appear to have actually read them.

Michael Colling
Corvallis, Oregon

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Arab world, Iraq and al-Qaeda

Unfamiliar questions in the Arab air

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From The Economist print edition

Getty Images

As al-Qaeda scores own-goals in its backyard, many Arabs, including some Iraqis, are beginning to rethink their position on violence in the name of resistance

OF ALL the films to extol the fight for freedom from imperialism, one of the most cheering to Arab hearts is the rousing 1981 epic, “Lion of the Desert”. A richly bearded Anthony Quinn plays the role of Omar Mukhtar, the simple Koran teacher who became a guerrilla hero, and for 20 years, from 1911-31, harassed the Italian forces bent on subduing Libya. In one memorable scene his Bedouin warriors, armed only with old rifles, hobble their own feet to ensure martyrdom as Mussolini's tanks roll inexorably towards them.

Such imagery, mixed with big doses of schoolbook nationalism and more recent real-life pictures of stone-throwing children facing Israeli guns, has bolstered a common Arab perception of “resistance” as an act that is just and noble. The romanticism is understandable, and not much different from how, say, the French view their own underground in the second world war. Yet the morphing in recent years of resistance into terrorism, and the confusion in Iraq, where a humiliating foreign occupation also brought liberation from Baathist tyranny, has increasingly called this iconography into question.

The undermining of entrenched myths is a slow and halting process. But it is subject to sudden, shattering jolts, such as the November 9th suicide bombing of three hotels in the Jordanian capital, Amman. In the minds of the killers, American-allied Jordan had become a rear base for the “crusader” invaders of Iraq, and so its hotels, the sort of places where crusaders and their minions congregate, were legitimate targets for the resistance.

Yet it is perhaps more than incidentally ironic that among the 60 people they killed was Mustapha Akkad, the Syrian-born director who created “Lion of the Desert”. His film, glorifying the bravery of Muslim resistance fighters, happened to be one of the few productions explicitly endorsed on

jihadist websites, albeit in a version that replaced the musical soundtrack with religious chants, and cut out all scenes showing women.

The global al-Qaeda franchise, whose Iraqi branch claimed responsibility for the Amman atrocity, has scored many own-goals over the years. The carnage in such Muslim cities as Istanbul, Casablanca, Sharm el-Sheikh and Riyadh has alienated the very Muslim masses the jihadists claim to be serving. By bringing home the human cost of such violence, they have even stripped away the shameful complacency with which the Sunni Muslim majority in other Arab countries has tended to regard attacks by Iraq's Sunni insurgent “heroes” against “collaborationist” Shia mosque congregations, funeral processions and police stations.

In Amman, al-Qaeda's victims included not only Mr Akkad and his daughter Rima, a mother of two, but also dozens of guests at a Palestinian wedding. The slaughter of so many innocents, nearly all of them Sunni Muslims, in the heart of a peaceful Arab capital, inspired a region-wide wave of revulsion. Far from being perceived now as a sort of Muslim Braveheart, the man who planned the attack, Abu Musab al-Zarqawi, may be the most reviled person in Jordan, the country of his birth. His own tribe, which had previously taken some pride in its association with the Iraqi resistance, has publicly disowned him. Tens of thousands of Jordanians have taken to the streets of Amman to denounce terrorism. Opinion polls, which had previously shown Jordanians to be at best ambivalent about jihadist violence, now show overwhelming distaste for it (see tables).

Similar changes in attitude have overtaken other Arab societies. Some 150,000 Moroccans marched in Casablanca earlier this month to protest against al-Qaeda's threat to kill two junior Moroccan diplomats kidnapped on the road to Baghdad. The execution by Mr Zarqawi's men of two Algerian diplomats and the Egyptian chargé d'affaires in Iraq earlier this year aroused similar indignation in their home countries. Two years of bloody jihadist attacks in Saudi Arabia have rudely shaken the once-considerable sympathy for radical Islamism in the conservative kingdom. A top Saudi security source reckons that 80% of the country's success in staunching violence is due to such shifts in public feeling, and only 20% to police work.

The enemies of life and joy

The direct impact of tragedy has not been the only impetus for change. Arab governments used to treat local terrorism as something that dented their prestige and should be covered up. Now they eagerly exploit the images of suffering to justify their policies. The way such events are reported in the press no longer hints at a reflexive blaming of external forces. The Arab commentariat, much of which had promoted sympathy with the Iraqi insurgency, and focused on perceived western hostility to Islam as the cause of global jihadism, has grown vocal in condemning violence. Jihad al-Khazen, the editor of *al-Hayat*, a highbrow Saudi daily, is a frequent and mordant critic of western policy. Yet his response to the Amman tragedy was an unequivocal call for global co-operation to combat what he blasted as the enemies of life, of joy, and of the light of day.

Popular culture, too, has begun to reflect such shifts in attitude. Recently, during the peak television season of Ramadan, satellite channels watched by millions across the region broadcast several serials dramatising the human toll of jihadist violence. One of these contrasted the lives of ordinary Arab families, living in a housing compound in Riyadh, with a cartoonish view of the terrorists who eventually attack them. Another serial focused, with eerie foresight, on a group of jihadist assassins in Amman. Their plot to murder a television

producer who is critical of their methods goes awry, killing three children instead. Unusually for an Arabic-language serial, even the villains are presented as conflicted souls, alienated from society and misled by dreams of glory and heavenly reward.

Religious leaders have chipped in. Moderate Muslim clerics have grown increasingly concerned at the abuse of religion to justify killing. In Saudi Arabia, numerous preachers once famed for their fighting words now advise tolerance and restraint. Even so rigid a defender of suicide attacks against Israel (on the grounds that all of Israeli society is militarised) as Yusuf Qaradawi, the star preacher of the popular al-Jazeera satellite channel, denounces bombings elsewhere and calls on the perpetrators to repent.

In Jordan, Mr Zarqawi's former cell-mate and mentor, Sheikh Abu Muhammad al-Maqdisi, long a firebrand proponent of widening holy war, has publicly given warning that excesses in Iraq have "defiled the image" of *jihad*. Another mentor, al-Qaeda's overall second-in-command, Ayman al-Zawahiri, is believed to have written a letter of advice to Mr Zarqawi that suggests he should desist from such provocatively grisly acts as sawing off captives' heads when a simple bullet would do.

Shifting Islamic thought 1

Is violence against civilian targets justified?
July 2005 *(Summer 2002)*, %

	Often/ sometimes	Rarely	Never
Jordan	57 *(43)*	31 *(22)*	11 *(26)*
Lebanon	39 *(73)*	19 *(9)*	33 *(12)*
Pakistan	25 *(33)*	19 *(5)*	46 *(38)*
Indonesia	15 *(27)*	18 *(16)*	66 *(54)*
Turkey	14 *(13)*	6 *(7)*	66 *(64)*
Morocco	13 *(40)*	5 *(15)*	79 *(38)*

How much confidence do you have in Osama bin Laden?
July 2005 *(May 2003)*, %

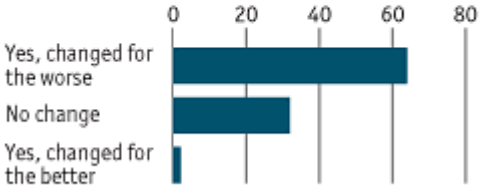
	A lot/some	Not too much	None
Jordan	60 *(55)*	20 *(26)*	18 *(18)*
Pakistan	51 *(45)*	11 *(7)*	12 *(20)*
Indonesia	35 *(58)*	27 *(26)*	10 *(10)*
Morocco	26 *(49)*	8 *(7)*	40 *(29)*
Turkey	7 *(15)*	6 *(7)*	73 *(67)*
Lebanon	2 *(14)*	9 *(18)*	78 *(64)*

Source: Pew Global Attitudes Project

Noteworthy in all these subtle shifts is the fact that they are, by and large, internally generated. Few of them have come about as a result of prodding or policy initiatives from the West. On the contrary, the intrusion of foreign armies into Iraq, the consequent ugly spectacle of civilian casualties and torture, and the continuing agony of Palestine, have clearly slowed down the Arab public's response to the dangers posed by jihadism.

Jordan changes its mind 2

Jordanians were asked whether their views on al-Qaeda had changed after the November 9th attacks on Amman, %



Source: Ipsos/*al-Ghad* newspaper
Poll of 1,014 adults, Nov 13th-14th

Now, or so it seems, it is the cooling of the Palestinian *intifada*, a slight lowering of the volume of imagery featuring ugly Americans in Iraq, and a general weariness with jihadist hysteria that have allowed attention to refocus on the costs, rather than the hoped-for rewards, of "resistance". At the same time, the rising tide of American domestic opposition to the war has begun to reassure deeply sceptical Arabs that the superpower may not, after all, be keen to linger on Arab soil for ever.

Is a shift in attitudes on the fabled Arab street important? The answer is, very much so. It surely affects, for example, the scale of private funding directed to the Iraqi insurgents. The volume of those very secret sums is impossible to determine, though the enthusiasm among, say, rich and conservative Sunni Saudis for thwarting both an infidel superpower and the perceived influence of Shia Iran in Iraq must be pretty strong. Even a trickle of cash translates quite directly into damage. And if it can be assumed that for each of the 700-2,000 foreign fighters in Iraq (the current estimate of the Brookings Institution), there are many others who prefer to play *jihad* with their cheque books, there has been much more than a trickle.

Governments follow the street

A more tangible measure of change is the behaviour of Arab states. Undemocratic though they may be, shaky Arab governments in many cases owe their baseline legitimacy to their own historical record of perceived resistance to foreign hegemony. The deeply unpopular invasion of Iraq placed them in a quandary. Any gesture towards aiding the success of this “American project” risked a fierce popular backlash. That equation has now altered, and the results are already evident.

The two Arab heavyweights, Egypt and Saudi Arabia, have lately begun to lend their diplomatic clout to resolving Iraq's troubles. The sudden urgency to do something, after years of fence-sitting, is prompted by several fears. One of these, seemingly justified by the Amman bombing, is that Iraq has turned from being a sponge for jihadist violence into a fountainhead that threatens the region.

Another is that Iraq's Sunni minority, by backing the insurgents, has isolated itself and paved the way for Iran, whose government is now in the hands of revolutionary Shia radicals, to expand its influence. Since the Iraqi elections scheduled for December 15th will create, for the first time, not an interim government but one with a four-year term, it has dawned on many fellow Sunni Arabs that Iraq's Sunnis must stake a role in their country's future or face further marginalisation.

Egyptian and Saudi efforts bore first fruits at a conference held in Cairo this week in a bid to reconcile Iraqi factions. The decisions reached were neither binding nor dramatic, and the whole event was pitched as preliminary to a broader meeting to be held in three months' time. Even so, the gathering of some 100 politicians of different stripes marked a big step in the crucial process of coaxing Sunnis back into the political game. The hosting of the event by the Arab League, an organisation that had previously kept aloof from Iraq's troubles, encouraged groups such as the Muslim Scholars' Association, which contests the legitimacy of Iraq's Shia-dominated government and has so far boycotted the political process, to join in. Although neither senior Baathists nor active leaders of the insurgency were present, several of the Sunni delegates are known to be close to these factions.

Military v political resistance

Iraq's president, Jalal Talabani, who is a pro-American Kurd, set the tone by saying that he would personally be happy to meet with active fighters in the resistance. Further gestures to appease the Sunnis came in the final communiqué, which asserted the right of “all peoples” to resist occupation, and called for a timetable for the withdrawal of foreign troops. Significantly, these clauses had been watered down, after heated debate with Sunni leaders who initially insisted on a direct endorsement of resistance action “against occupation forces”. The resolution also expressly declared that terrorism cannot be considered a form of resistance, and appeased Shia feelings further by rejecting the Sunni jihadists' contention that Shi'ism is a heretical sect.

Obviously, the vague wording over the key issue of “resistance” is open to interpretation. Shia parties, such as the Islamist-oriented United Iraqi Alliance, led by Iraq's prime minister, Ibrahim al-Jaafari, have long insisted that they are engaged in “political resistance”; the fastest way to end the occupation, they argue, is to achieve the security that will enable the troops to leave.

For their part, pro-resistance Sunni parties contend that they, too, have been subject to terrorism. They point to incidents such as the recent exposure, by American forces, of a secret jail, run by the Shia-controlled police, where hundreds of Sunni captives were mistreated. Attacks on foreign

soldiers remain legitimate in their eyes. As for political resistance, a senior member of the Muslim Scholars' Association, Abd al-Salam al-Kubaisi, acidly remarked that its strongest proponents seem to be the American public, “since they are calling daily for the troops to leave.”

Hardline insurgent leaders remain even more adamant. Baathist websites denounce Iraq's government as “spies and agents”. A statement from Mr Zarqawi denounced the Cairo conference as an American ploy “to make Sunni Muslims accept the dirty political game”. The only dialogue permissible, he said, was “by the sword and seas of blood”.

Yet despite such verbal sparring and the vicious bloodletting on the ground, a degree of convergence can be detected. A huge majority of Iraqis want the occupation to end—some 82% according to a poll conducted by the British Ministry of Defence in August. The argument is over how to go about it. Most Iraqis also shun jihadist zeal, including many members of the broader Sunni resistance who feel that the radicals tarnish their cause. Despite deep mistrust of political institutions that have failed to provide security and a decent infrastructure, and despite the heightening of sectarian loyalty generated by two years of fear and chaos, the weary Iraqi public does not appear to have lost faith in the possibility of a political solution.

The two largest forces in the fragmented Sunni spectrum, the Iraqi Islamist Party and the Iraqi National Front, a more secular grouping that includes former Baathist officers, are actively rallying Sunnis to turn out to vote. Other Sunni politicians report a growing willingness among the non-jihadist groups, which make up the bulk of the insurgency, to consider a deal to wind down the fighting.

AP

Moroccans, after their diplomats were seized in Baghdad, convey a new message

Their main stated demands so far have been an immediate pullback of foreign troops from Iraqi cities and a timetable for full withdrawal. With even the Pentagon now hinting at plans to draw down troop levels significantly next year, and with Congress pushing for a phased withdrawal, such demands no longer look beyond possibility. Iraq's own, much-maligned security forces, meanwhile, are slowly getting fitter. Troop strength in the reconstituted army recently passed 100,000, nearing the targeted level of 135,000. The quiet re-enlistment of Baathist officers, who had been sacked wholesale early in the occupation, has also worked to restore a measure of Sunni confidence—though there are few Iraqi units where the insurgency is fiercest.

At the same time, subtle realignments are changing the shape of Shia politics. The party of Muqtada al-Sadr, the young cleric whose fiery attacks on the occupation proved hugely popular with the urban poor, has joined the governing United Iraqi Alliance, a broad group dominated by

two pro-Iranian Islamist parties. Meanwhile, prominent secularists have abandoned the alliance, leaving it a straightforward representative of activist Shia Islamism. Since many Iraqi Shias feel uncomfortable mixing religion and politics, and associate the alliance with the perceived weakness of the government, this might strengthen the nationalist centre.

Growing weary of war

The fact remains that Iraq is a nasty and dangerous place, where even a widening commitment to political solutions may not prevent disintegration into civil war. Recent revelations about police death-squads targeting Sunnis, and the bombing of Shia mosques, have intensified sectarian animosities. The vexed questions of federalism and how to share oil revenues remain to be settled. The secret objectives of Iran—whether it just wants to burn American fingers or to install a look-alike theocratic state—are unknown. The jihadists who have made Iraq their playground may have lost their wider appeal, but they are not going to disappear.

Yet there appears to be a growing consensus, within Iraq and outside, that the time has come to settle down and get on with life. A columnist in a Saudi daily, *al-Sharq al-Awsat*, Mashari Zaydi, suggests that Arabs have been torn by a struggle between two world-views, one hard, absolutist and aspirational, the other realist, compromising and practical. While the realist approach, he says, may not win all you want, the absolutist one risks losing everything you have.

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The home front

Not whether, but how, to withdraw

Nov 24th 2005 | WASHINGTON, DC
From The Economist print edition

EPA

As the war in Iraq grows ever less popular, new thinking at last is in the air

THERE was plenty on President George Bush's plate during his trip to Asia, from discussing religious freedom with China's leaders to drinking fermented mares' milk in Mongolia. But events back home kept distracting him. There's “an important debate underway back in Washington about the way forward in Iraq,” he told reporters in Beijing on November 20th. Indeed there is.

The latest storm broke after John Murtha, a Democratic congressman from Pennsylvania, said it was “time to bring [the troops] home”. In a passionate speech delivered on November 17th, he argued that American forces have “become a catalyst for violence” and are impeding progress towards stability. Sunnis, Saddamists and foreign jihadists are “united against US forces”, he said. Iraq's fledgling security forces will only be “incentivised to take control” if they are “put on notice that the United States will immediately redeploy”. He later clarified that he expected a pull-out to take about six months.

Mr Murtha's outburst started a discussion in which neither Republicans nor Democrats are sure of their ground. The administration's first instinct was to attack Mr Murtha. Scott McClellan, the White House spokesman, said it was “baffling that he is endorsing the policy positions of Michael Moore and the extreme liberal wing of the Democratic Party.”

Someone must have realised the foolhardiness of getting personal about a man who won a Bronze Star and two Purple Hearts in Vietnam. Especially since Mr Murtha, now in his 70s, took the trouble of visiting Iraq's Anbar province—where the insurgency is at its roughest—before making his speech. When Mr Bush and Vice-President Dick Cheney later stood up to rebut the congressman, they started by acknowledging that he was a patriot.

But not, they suggested, a wise man. Mr Cheney made the case most forcefully (see Lexington), in a speech on November 21st. “It is a dangerous illusion to suppose that another retreat by the civilised world would satisfy the appetite of the terrorists and get them to leave us alone.” In fact, he added, “such a retreat would convince the terrorists that free nations will change our policies, forsake our friends, abandon our interests whenever we are confronted with murder and blackmail.”

Mr Cheney's argument has undeniable logic. If America were to “cut and run”, to use the shorthand that hawks in Washington always apply to their opponents' plans, al-Qaeda would indeed regard it as a victory. Even just talking about withdrawal emboldens the enemy, argues Michael Rubin of the American Enterprise Institute, a conservative think-tank. “Murtha's comments have gotten Americans killed,” he says, “They've convinced the terrorists they are on the right track.” A sudden dash for the exit, adds Mr Rubin, would also warn all current and future allies that they could not trust America.

On the other hand, Mr Murtha's opposing argument is also logical. While some of the insurgents are fighting for a global caliphate, and some to maintain the supremacy of the Sunni minority, others are doing so because they resent the presence of 160,000 American troops in their country, or because those troops have killed or humiliated someone dear to them. The first group would doubtless be inspired to greater violence by an American withdrawal, but the last probably would not.

Mr Murtha's other point—that having the world's greatest army protecting it reduces the Iraqi government's incentive to protect itself—also makes sense. American protection may also reduce the urgency to create a political system in Iraq that can stand on its own. The question therefore is not whether America should eventually reduce its forces in Iraq, but how to ensure that the Iraqi security forces “stand up” as America “stands down”.

That has always been Mr Bush's line, but with no firm details. This week, however, some concrete numbers started to be tossed around. On November 20th, Donald Rumsfeld, Mr Bush's defence secretary, said that once Iraq's December 15th elections are safely past, he plans to withdraw some 20,000 troops. (This, be it noted, was not far off the number of extra troops deployed to police the elections.) On November 22nd, Condoleezza Rice, the secretary of state, told Fox News that since Iraqi forces were getting “more and more capable”, she did “not think that American forces need to be there in the numbers that they are now for very much longer.” The next day, the *Washington Post* reported that the Pentagon had set benchmarks for the circumstances under which troops could be withdrawn, and that under a “moderately optimistic” scenario, the number could be reduced by about a third, to 100,000, by the end of 2006.

How all this will play with the American public is tricky to predict. Some 54% of Americans think the war was a mistake, and only 32% expect it to result in a stable and reasonably democratic Iraq. John Mueller, a professor of politics at Ohio State University, pointed out in a recent column that support for the Iraq war after 2,000 American deaths is as low as it was for the Vietnam war after ten times as many. Either Americans have grown less tolerant of casualties, or they doubt that the war on terror is as important as the struggle against communism was.

But opposition to the war does not translate directly into support for immediate withdrawal. Only about a fifth of Americans favour this. Most would like to see the troops pulled home over a longer period, presumably because they understand that simply letting Iraq collapse would have consequences.

Letting South Vietnam collapse, noted Melvin Laird, secretary of defence under Richard Nixon, in the current issue of *Foreign Affairs*, resulted in 2m refugees, 65,000 executions and 250,000 people sent to re-education camps. Gloomily, he said he expected no better in Iraq, implying that

Iraq's government would merely fold if America retreated.

Politically, the effect of the Iraq row is milder than it might have been. Neither Mr Bush nor Mr Cheney is running for re-election, so both men are insulated, up to a point, against public opinion. And although there are mid-term elections next year and a guaranteed change of commander-in-chief in 2008, few candidates want to be seen as quitters. This was the background to the vote last week that followed Mr Murtha's bombshell. In the House, Republicans called a vote on whether to pull out the troops immediately, in order, they said, to force the Democrats to stand and be counted. Only the fringiest Democrats could back such a motion; it failed by 403 votes to three.

Earlier, in the Senate, cooler heads had passed by 79-19 a bipartisan motion calling on the president to provide quarterly reports on the transfer of responsibility for Iraq's security to Iraqis. Republicans backing the motion said it merely reaffirmed Mr Bush's current policy; Democrats said it was meant to improve it. Nay-voters were split between Republicans who thought it undermined the president, and Democrats who thought it let him off the hook.

As things stand, Iraq is likely to hurt the Republicans quite badly in 2006, though it may not hand control of Congress to the Democrats. As for the presidential poll of 2008, all speculation is just that.

Among potential Republican candidates, Senators John McCain and Chuck Hagel both argue that America should send more troops to defeat the insurgency. Democratic presidential wannabes, meanwhile, mostly wax eloquent on how Mr Bush misled the country into the war and bungled its execution, but have less to say about what America should do now. Senators John Kerry and Russ Feingold, plus former vice-presidential nominee John Edwards, all propose gradual reductions in troop levels. Senator Hillary Clinton is hedging artfully.

Senator Joe Biden offers a more original Democratic proposal. This week, he urged greater involvement by America's allies and Iraq's neighbours in cajoling Iraqi Shias, Kurds and Sunni Arabs to forge a political consensus. He also argued, rather airily, for greater involvement by Iraqi firms in reconstruction projects, and a different mix of American forces in Iraq, with fewer troops but more embedded trainers, civil-affairs units and special forces.

All of which is food for thought. But for now, the responsibility for fixing Iraq lies with those who broke it.

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The south-western economy

Dreams in the desert

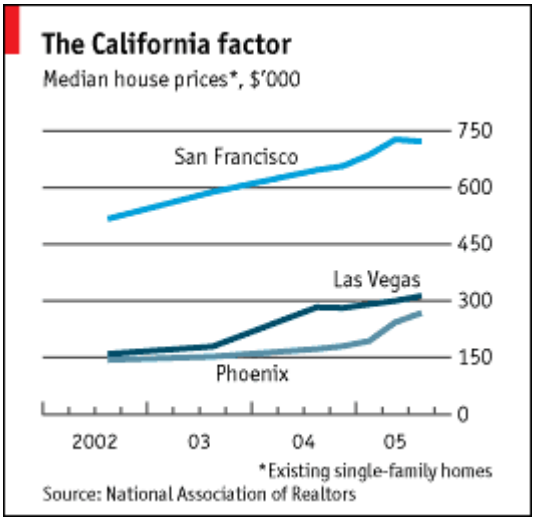
Nov 24th 2005 | LAS VEGAS AND PHOENIX
From The Economist print edition

Surging growth, soaring house prices, incomers in their thousands: how much longer can boom times last in the West?

DRIVE down the crowded interstate to the outskirts of Phoenix, Arizona, and new housing complexes sprawl across what used to be the desert. In Las Vegas, Nevada, new high-rises with names like Allure or Ivana glitter over the town, and endless subdivisions, packed with houses fresh off the assembly line, push up against the brown hills.

To say that the south-west is growing fast is an understatement. In the year to July 2004, Phoenix added more people (29,826) than any other American city. Las Vegas, which is roughly one-third the size of Phoenix, came fourth, adding 17,923. The property market has responded accordingly. Median prices for single-family houses in greater Phoenix have nearly doubled in three years (see chart), while Las Vegas posted a whopping 53.7% gain in existing house sales in the year to last autumn.

The weather, which is good for golfing nearly all year, has a lot to do with it. “You can have a nice house, a decent commute, and a nice quality of life,” says Janet Napolitano, the governor of Arizona. Baby-boomers are coming, and others are scooping up second homes. Demand has outpaced supply: a new house in Phoenix can take seven or eight months to get, says Elliott Pollack, a property consultant based in nearby Scottsdale.



As for the prices, local estate agents claim that the desert is merely coming into line with the coasts. Their region, they say, is still affordable. “We were way behind California, New York, other states. When we went to 52% appreciation rates, we were just catching up,” says Myrna Kingham, president of the Greater Las Vegas Association of Realtors. Ms Kingham argues that Nevada also has a land-supply problem; the federal government owns about 85% of the state, much of it overseen by the Bureau of Land Management (BLM). “We need the federal government to start releasing more land,” she says. At a BLM auction last week in Las Vegas, 3,000 acres (1,200 hectares) sold for $800m.

It is not just individuals who want to soak up 300 days a year of sunshine. Companies, too, are migrating. Las Vegas remains more or less a one-industry town, to which new casinos keep coming, but Arizona is experiencing something of a technology boom. Google has been nosing around to find space for a new engineering plant, eBay is opening a data centre next year and Intel is spending $3 billion to build a new factory in Chandler, an especially fast-growing Phoenix suburb.

For companies, the main draw is low taxes. Ms Napolitano, unusually for a Democrat, wins top marks as a pro-growth governor. She has worked to slash the business-property tax and to give tax credits for research and development. In Nevada, conditions are even better: the state has no income tax on corporations or individuals, since it takes in plenty from gambling. Both states offer good transport links to the rest of the country, and labour costs are low compared with California.

And there lies a clue. If there is a constant impulse behind the western boom, it is the exodus from California. People still love the Golden State, but many are being forced out by the cost of living. Median house prices in the San Francisco Bay area are still well over double those in Phoenix or Las Vegas. “Housing is so cheap compared to California that most people can't believe it,” says Mr Pollack. This year some 120,000 Californians will pack up and move to Arizona, equivalent to perhaps 2.5% of Arizona's population. As for Las Vegas, some 35% of newcomers (judging by the evidence of their driving-licence records) are from California, according to the state university's Centre for Business and Economic Research.

So how long can the good times last? The region, rich in minerals, is no stranger to boom and bust, and Phoenix went through a tough time in the early 1990s. Already, the property market is showing signs of sobering up. In Las Vegas, median home prices fell a modest $2,000 (0.6 %) from September to October, and it is taking twice as long to sell some houses. Mortgage rates are moving up with the Federal Reserve's increases in interest rates.

In Arizona, Ms Napolitano is bullish. Development and house-building, she says, are surging because the state is growing so quickly; “so it's a different kind of bubble,” she says. “I think that as long as our population growth is sustained, the real-estate market will be very robust.” Mortgage rates will have some effect, but “at the margins”. In Las Vegas, Ms Kingham also shrugs off mortgage-rate worries.

Others are less sanguine. Mark Zandi of Moody's Economy.com expects house prices to fall significantly. The growth, he notes, has been driven by aggressive mortgage lending and speculation (and locals corroborate that speculation has been heavy in Las Vegas). He predicts a correction of around 10% in prices in Las Vegas and Phoenix—sharp, but not drastic.

Even without a housing dive, the south-west faces longer-term problems. Already, everything from electricity to roads to Las Vegas's mammoth airport-security lines show the strains of growth. But no problem looms larger than water. Grass is a rare sight in Las Vegas.

The West gets much of its water from the well-dammed Colorado river, with seven states agreeing in 1922 on how to divvy up the water. Arizona is ready for growth, says Ms Napolitano. The state has enough water, and has even been banking some during the recent drought. But Nevada gets a puny allotment from the Colorado, as much as it needed for its population 80 years ago. The state is now trying to persuade ranchers in northern Nevada to release some groundwater to thirsty Las Vegas.

Even in Nevada, though, things may be better than they seem. Water used indoors gets returned to the Colorado river through waste-water treatment plants, says Lambis Papelis of the Desert Research Institute, a non-profit group based in Reno. So if everyone was living indoors, things would be fine: “Theoretically we could grow vertically forever,” he says. Plenty of condos are indeed reaching skyward; but the trouble, as Mr Papelis says, lies with the roughly 40% of water that is sprinkled on people's lawns. This goes into the ground and gets lost.

Las Vegas has rules about this. New developments allow lawns only in front yards, not back ones, where artful cactus landscaping has to do instead. But the future still looks tricky. “What has saved us so far is that the upper Colorado river states—Wyoming, Colorado, Utah and New Mexico—don't use their full allocation [of water] yet,” says Mr Papelis. If they start to, Vegas will

be in trouble.

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Foster care

Putting families first

Nov 24th 2005
From The Economist print edition

Children are being taken into care too quickly and for too long

THE budget bill passed recently by the House of Representatives includes around $50 billion in spending cuts, many of them aimed at federal programmes for the poor. This includes trims of around $5 billion in child support, $600m for children in foster care and around $700m in food stamps. A similar bill from the Senate contains $34 billion of cuts with far fewer swipes at social-welfare programmes, but both bills include between $60 billion and $70 billion in tax cuts that disproportionately favour the rich. Child advocates are enraged. As states consider reforming their child-welfare systems, big cuts in social services are not helpful.

Tales of missing, starved, abused and even murdered children in adopted homes and foster shelters are alarmingly common. Some escape the attention of over-burdened social workers; others are shuttled from one foster-care placement to another for years on end. Last year, a Pew Commission on Children in Foster Care concluded that, because of the way federal funding works, children were plucked from their families too soon and left to fester in the system for too long. And although judges play a critical role in moving children to safety, family courts are among the most under-funded in the system, with few incentives to attract top lawyers and judges and little collaboration between the courts and child-welfare agencies. Dependency lawyers tend to be overworked and underpaid, with predictably bad results for the children they represent.

More than 500,000 children are in foster care in America, most of them black or Latino. They remain in the system for an average of three years. These children, typically placed in the state's care after suffering abuse and neglect at home, often endure a demoralising parade of indifferent caseworkers, lawyers, judges, teachers and foster parents, who offer little real support in their quest for a stable home. For those who cannot return to their birth parents, the situation is grim: in 2003, 119,000 children in America were waiting to be adopted, 67% of whom had been in foster care for more than two years, according to the Department of Health and Human Services (HHS).

When such children “age out”, or turn 18, as 18,000-20,000 do every year, they are suddenly cut off from all special services such as housing and counselling. Studies show that they disproportionately drop out of college, become homeless and unemployed, turn to drugs and alcohol and spend time in jail.

The federal government pays around half America's $22 billion child-welfare bill, according to the Urban Institute; the rest comes from state and local governments. But states have not been held accountable for how they spend this money. In an extensive three-year audit of state child-welfare systems, the HHS found that not a single state was in compliance with federal safety standards. When it came to the seven federal standards used to assess children's programmes, some of which are almost embarrassingly basic (eg, “Children are first and foremost protected from abuse and neglect” and “Children receive adequate services to meet their physical and mental health needs”), 16 states did not meet any of them, and no state met more than two. The federal agency is now running a second round of audits, to assess whether states are now complying with their

own improvement plans.

“We are spending a great deal of money to damage children,” says Marcia Robinson Lowry, director of Children's Rights, an advocacy group. There are no real consequences for states when they fail to meet federal targets, she argues, so class-action lawsuits are the only recourse. Children's Rights has represented foster children in 13 court cases in the past decade. Most of these have ended in a court-ordered settlement that sets the group as a watchdog over a state's mismanaged and overburdened social-services department.

But using the courts to solve America's child-welfare problems is expensive and inefficient. The best answer, many think, is for states to spend money on keeping families together, by investing in services such as child care and counselling, rather than putting children in care. This would require allowing states to use federal funding in different ways. Most federal dollars now begin flowing to states only when children are removed from their families, giving states a perverse incentive to keep children in foster care, explains Carol Emig, the director of the Pew Commission. Instead, the commission suggests that states need a little more federal money to cover all children, not just poor ones, and the flexibility to create a range of services that might keep children from entering care or help them leave care safely.

Such a change carries quite a price-tag: $5 billion over ten years. But advocates say it will bring long-term savings by producing better educated, less delinquent children and more united families. If states safely reduce their foster-care rolls, they can then reinvest dollars earmarked for foster care in other child-welfare services. Meanwhile, federal reviews will hold states to their programme promises. President George Bush has proposed, alternatively, that states should convert their foster-care entitlement programmes into block grants. That would give flexibility at first but, over time, it would amount to a cut in funds.

States and cities can already apply for waivers from federal funding restraints; some 20 states have waivers now. Advocates of flexible funding point to Illinois, a waiver recipient, where the foster-care population has been cut in half and adoptions have more than doubled since 1997. And in late October officials in New York City announced that the number of children in foster care has dropped to around 18,000, half of what it was six years ago. Once home to one of the worst foster-care systems in the country, the city now works to keep families intact and help them look after their children rather than taking the youngsters away. As a result, “the spigot coming into the system has been narrowed”, explains David Tobis, director of the Child Welfare Fund, a local organisation. The money saved from federal entitlements—an estimated $27m in the fiscal year that began in July—will be put back into preventive services.

October also saw Arnold Schwarzenegger, California's governor, sign into law a number of bills to help the state's foster children—more than 80,000 of them. Most of the new laws will help teenagers when they turn 18, by making sure they stay in college and have somewhere to live.

Amid all the horror stories, it can be easy to lose sight of the people who make foster care work. After describing the madness of waiting all day at court to represent a client, only to receive five minutes of a distracted judge's time, one social worker goes on to describe some of the good foster parents she has met. Her voice grows tender when she describes one couple who have taken in a young, physically disabled child. “You tend to hear about the system's flaws”, she explains. “But there are also so many other amazing things.”

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Hunting

The shaggiest prize

Nov 24th 2005 | SHERIDAN, WYOMING
From The Economist print edition

Bison-hunting returns to Montana

ON NOVEMBER 15th, after a 14-year hiatus, Montana re-opened hunting season on bison drifting across the northern border of Yellowstone National Park. Within the park, they are protected and essential to its identity. Outside it they are now, once again, fair game for trophy-hunters.

In 1902 23 wild bison were left in Yellowstone, the only part of the country where they survived. The banning of commercial hunting, and careful management of the animals that were left, has changed all that. Yellowstone now has a record 4,900 bison.

Wandering wild bison are no respecters of fences, and think any patch of grass is their own. They are also unafraid of humans, and quick to charge. Cattlemen are especially nervous of them because they may carry brucellosis, or undulant fever, which can in theory be transmitted to cattle and cause spontaneous abortions.

Chris Smith of the Montana Department of Fish, Wildlife and Parks says much has changed since the last hunt. “We used to have a zero-tolerance policy. Every bison entering Montana was hazed back into the park or shot. Now we've got 480,000 acres in Montana where bison are tolerated.” Such a policy, Mr Smith says, “re-engages the hunter”, rather than simply treating the bison as a pest to be eliminated.

And hunters are delighted to be re-engaged. The Montana Department of Livestock, which still has to give permission for hunts, has issued 50 licences; 6,000 people had applied for one.

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Economist.com WORLD NORTH AMERICA

Military life

Green clothes, green minds

Nov 24th 2005 | FORT CARSON, COLORADO
From The Economist print edition

The Pentagon shows its softer side

THE hotel ballroom falls silent as the speaker gazes at his audience. He asks them to close their eyes and envision people who are less fortunate and live in a world without electricity. After a solemn pause, he says: “You're carrying the torch, so that your children and their children can have a better world to live in.”

The speaker is not some New Age guru, but Ronald Johnson, a major-general in the Army Corps of Engineers, speaking to more than 300 local residents and soldiers at a sustainability conference at Fort Carson army base in Colorado Springs. Listening to him and other officers urging soldiers to become “environmental stewards” and to “lessen their ecological footprint” on the planet, you might imagine they worked for Greenpeace. In fact, they are only one sign of an unexpected shift. The army is also building more energy-efficient buildings, reducing hazardous air pollutants and getting more of its electric power from wind, biomass and other renewable sources.

Inevitably, money has something to do with it. The Department of Defence has been forced to spend billions of dollars to clean up toxic sites. But what began as sulky compliance with environmental laws has morphed into something more proactive. Fort Carson has invested in rain sensors for its irrigation systems which, it hopes, will save it $80,000 a year; and it may save another $30,000 annually from cleansing and recycling much of its hazardous paint-cleaning solvent, rather than paying to dispose of it.

Reducing the military's ecological footprint makes it “stealthier”, claims Michael Cain, director of the army's Environmental Policy Institute. “It saves us money, provides mission support and it supports the environment,” he adds. As an example, army engineers have slashed the amount of chromium, cadmium and other hazardous materials used in building Stryker combat tanks, which in turn reduces the health risk to soldiers. At the army engineering school in Missouri, officers are being taught the mysteries of building sheds with recycled wood, double-insulation walls and solar panels.

Greens still battling the Pentagon over the mess it has left across the country may well be sceptical, but progress has been made on the army's promise to meet various targets within 25 years. The Environmental Protection Agency has already declared Fort Lewis, in Washington state, clean enough not to need such frequent inspections. The air force is the largest federal purchaser of green power in the country: two of its bases are powered solely by renewable energy, mostly wind.

The Pentagon and environmental groups are even working together. For instance, various bits of the American armed forces have teamed up with the Nature Conservancy to buy land around their bases from ranchers. This gives soldiers more space in which to play their war games, but also means that thousands of acres of native habitat are saved from housing developments.

Rappers and crime

What's in a name?

Nov 24th 2005 | NEW YORK
From The Economist print edition

Featuring a peculiarly capacious shoe-box

WHEN two brothers adopt the surname Gotti in honour of a New York mafioso, run a record company called Murder Inc. and name their recording studio “The Crackhouse”, you might think them drawn to the criminal world. Not so, it is a cultural thing, say lawyers for Irv and Chris Gotti, two music moguls on trial this week for money-laundering. The gangster image, they say, is a marketing strategy for the rap-music industry, where popular songs routinely celebrate crime and violence.

The prosecution contends that the Gottis (born Irving and Christopher Lorenzo) are real crooks, not just fake ones. It charges them with having helped a convicted big-time crack-cocaine dealer, Kenneth “Supreme” McGriff, to launder $1m through their record company, accepting his cash in bags and boxes and writing corporate cheques in exchange. On Monday the court paused to debate whether $70,000 in small bills could physically have been stuffed into a shoebox, as a witness claimed. The conclusion: it depended on the size of the shoe.

For rap fans, the main interest of the trial has lain in the light it may shed on the attempted murder of 50 Cent (born Curtis Jackson), perhaps the biggest American rap star of the moment, who was shot several times at close range in Queens in May 2000. No-one was charged, and Mr Cent's miraculous survival added greatly to his legend. A witness told the Gotti trial this week that associates of Mr McGriff had carried out the attack, because Mr Cent had “dissed” both Mr McGriff and also Ja Rule (born Jeffrey Atkins), a rapper for the Gottis' record label, in his lyrics.

The defence argued for excluding this evidence, calling it irrelevant and fearing that the jury would be swayed merely by Mr Cent's immense popularity. It would be like linking the Gottis with “a plot to assassinate Bob Dylan”, said Gerald Shargel, Chris Gotti's lawyer, struggling to explain rap culture in terms that the presiding judge, Edward Korman, might understand. The judge agreed; from now on, all mention of Mr Cent is banned in court.

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Economist.com WORLD NORTH AMERICA

Lexington

Out of the bunker

Nov 24th 2005
From The Economist print edition

Dick Cheney may be hugely unpopular, but George Bush needs him badly

"A BONELESS wonder" was how Winston Churchill once described the first Labour prime minister, Ramsay MacDonald. Dick Cheney is about as far from boneless as it is possible to get. The vice-president is the most uncompromising politician in today's Washington: an embodiment of ideological rigidity who not only has plenty of bones of his own, but also lots of other people's bones stored in the Old Executive Office Building. Three years ago he was the keenest advocate of invading Iraq. Today he is the steeliest defender not only of that war but also of the wider war on terror, in which—in his view—Iraq is a mere front.

Mr Cheney's natural reaction to every brickbat and setback is to dig deeper and fight harder. The chorus of war critics is getting louder. So Mr Cheney questions not just their arguments but their integrity. John McCain wants to prevent Americans from engaging in "cruel, inhuman and degrading" punishment. So Mr Cheney tries to persuade Senate Republicans that tying the president's hands may cost "thousands of lives". Mr Cheney's hardline aide, Scooter Libby, is forced to resign. So Mr Cheney replaces him with an even harder-line figure, David Addington, the man who led the fight to keep the proceedings of Mr Cheney's energy task-force secret, who drafted Alberto Gonzales's 2002 memorandum that argued that enemy combatants are not covered by the Geneva Conventions, and who was behind the presidential order establishing military tribunals.

Mr Cheney's defence of his position has a quality rare in Washington: the sound of conviction. The man who Mr Bush calls "Vice" is not just playing the traditional role of a vice-president in an embattled presidency—like Spiro Agnew, savaging the "nattering nabobs of negativism" during Vietnam. He is defending a policy he passionately supports. For Mr Cheney, the big fact about America is that it is at war with Islamofacism. And it must do everything possible—from beating

back war critics to reserving the right to torture detainees—in order to win that war.

This uncompromising stand has raised eyebrows in the Washington establishment. “The real anomaly in the administration is Cheney,” Brent Scowcroft recently told the *New Yorker*. “I consider Cheney a good friend—I've known him for 30 years. But Dick Cheney I don't know any more.”

In one way, the idea that Mr Cheney has undergone a personality change is unfair: he was always a belt-and-braces pessimist and an ardent conservative. As a Wyoming congressman, he compiled a voting record to the right of Newt Gingrich's (he voted against the equal-rights amendment, for example); as defence secretary, he constantly found his most powerful prejudice confirmed, that the world is a very dangerous place. But even allowing for this, September 11th 2001 clearly changed him. As Ivo Daalder of the Brookings Institution points out, a pragmatic hardliner became an ideological hardliner. He lost his patience with the world's ditherers and debaters. And his world-view was sprinkled with neo-conservative pixie-dust.

Somewhere in this transformation Mr Cheney seems to have lost his most prized political asset—his judgment. Whenever he had a chance on Iraq, he seems to have pushed the evidence further than it could reasonably be pushed. He not only argued that Saddam had weapons of mass destruction; he insisted that he was close to acquiring a nuclear bomb. He not only complained in private about the hand-wringers and poseurs in the United Nations; he suggested from the first that America could go ahead without the blessing of that body, as if international opinion is an irrelevance in modern warfare. Somehow, one of life's natural Hobbesians not only underestimated how difficult it would be to transform a Baathist dictatorship into a functioning democracy, but even bought the clap-trap about Iraqis greeting Americans with flowers.

Blood brothers

Which brings us to a question that is currently perplexing Cheney watchers: why is the administration relying so heavily on such a divisive, even discredited, figure to defend the Iraq policy? Mr Cheney's poll numbers are dismal. The indictment of his chief of staff has raised serious questions about his honesty. And his defence of torture makes many middle-of-the-road people nervous.

One reason is that the administration is hardly spoiled for choice when it comes to articulate defenders of the war (and Mr Cheney is nothing if not articulate). Another is that the time for emollience has long passed. So what if Mr Cheney can't charm nervous independents and wavering Democrats? These days the administration is in the business of shoring up the conservative base, which is the only thing that stands between Mr Bush and free-fall. But the most important reason is that Mr Bush still agrees with Mr Cheney.

Washington has recently been consumed by rumours that Mr Cheney is for the high jump. Didn't he spend a suspicious amount of time in the sticks recently, holidaying in Wyoming and pheasant-hunting in South Dakota? And wasn't he one of the last to know that Mr Bush had chosen Harriet Miers for the Supreme Court? The rumour-mongers interpret Mr Cheney's recent ubiquity as more proof that he is desperately trying to save his job.

But the truth is more mundane. Mr Bush may well have been annoyed that his most trusted adviser promised an easy victory in Iraq, and that he over-sold the case on Iraq's WMD. He is certainly embarrassed by the Plame affair. But Mr Bush was just as transformed by September 11th as Mr Cheney was. He was just as keen on getting rid of Saddam. And he is remarkably loyal to his fellow Iraq hawks, as Donald Rumsfeld's continued presence in the administration makes clear. For better or worse, Mr Bush and “Vice” will probably have to ride this storm together.

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Latin America

Redrawing the political map

Nov 24th 2005
From The Economist print edition

A dozen presidential elections over as many months are likely to produce more muddle-through rather than a shift further left

The year of the vote
Latin America's elections to end of 2006
Country | Due date | Likely outcome
Honduras ★✕ | Nov 27th | Opposition Liberals?
Venezuela ✕ | Dec 4th | Chávez to tighten grip
Chile ★✕ | Dec 11th | Michelle Bachelet, but in run-off
Bolivia ★✕ | Dec 18th | Evo Morales, but without majority
Haiti ★ | Dec 27th | A test for the UN
Costa Rica ★✕ | Feb 5th | Centre-left victory?
Colombia ✕ | March | Uribe majority?
El Salvador ✕ | Mar 12th | Conservative victory
Peru ★✕ | Apr 9th | Wide open
Dominican Republic ✕ | May 16th | Depends on alliances
Colombia ★ | May 28th | Second term for Uribe
Mexico ★✕ | Jul 2nd | Tight three-way race
Brazil ★✕ | October | Lula or Serra?
Ecuador ★✕ | Oct 15th | Wide open
Nicaragua ★✕ | Nov 27th | Ortega returns? Or a centrist independent?
Venezuela ★ | December | Chávez again
GUATEMALA*
MEXICO
(BELIZE)
HONDURAS
EL SALVADOR
NICARAGUA
HAITI
DOMINICAN REPUBLIC
1,000 km
ATLANTIC OCEAN
(GUYANA)
(SURINAME)
(FRENCH GUIANA) (to France)
COSTA RICA
PANAMA*
VENEZUELA
COLOMBIA
ECUADOR
Amazon
PERU
BRAZIL
BOLIVIA
CHILE
PARAGUAY*
URUGUAY*
ARGENTINA*
PACIFIC OCEAN
Election type:
★ Presidential
✕ Legislative
Source: The Economist
Current government:
Left of centre
Right of centre
Interim
*No imminent elections

ON SUNDAY November 27th, voters in the small Central American country of Honduras go to the polls to elect a president, the national Congress and mayors. Normally this would attract little attention. But the Hondurans will fire the starting pistol for a Latin American electoral marathon, with no less than a dozen presidential contests and 13 legislative elections over the coming year. Involving Brazil and Mexico, the region's two giants, and four out of the five mid-sized South American republics (see table above), these elections will colour the region's political map for years to come.

Many onlookers predict that Latin America will move further left. That is possible. For the first

time, one or two unabashed admirers of Venezuela's Hugo Chávez, who nowadays defines himself as a “21st-century socialist”, could be elected. Noisily as Mr Chávez would gloat over such triumphs as defeats for the influence of the United States in the region, they are almost certain to be confined to small countries, such as Bolivia and Nicaragua.

The bigger picture is broadly one of continuity—for better or for worse. The moderate left has done well in Latin America since the late 1990s. That is partly because popular enthusiasm for the inflation-busting free-market reforms of the “Washington consensus” (ie, sound macro-economic policies, free trade, privatisation and deregulation) was undermined by a severe regionwide recession in 1998-2002. But it is also because democracy has finally become a habit in Latin America and, with it, the normal healthy alternation of power. The end of the military veto against the left encouraged it, in turn, to adopt more responsible policies.

The result has been that, instead of dismantling the reforms of the 1990s, most of the region's politicians cleave to a new “post-Washington” consensus, combining (more-or-less) sound macro-economic policies with a greater emphasis on social spending, and some tinkering with further liberalisation. In most places, this new consensus is likely to survive electoral examination. That is because the region's economies have been coasting along on the back of a commodity-price boom, and many incumbents are fairly popular. (Peru's Alejandro Toledo is an exception).

But there are many discontents. Four Latin Americans in ten remain poor. Opinion polls suggest that two sets of issues will be uppermost in voters' minds: first, a demand for decent jobs along with an attack on poverty and Latin America's sharp socio-economic inequalities; and second, worries about security and crime—paramount in Colombia and parts of Central America, where conservatives tend to do well. Elections will be decided on these national issues, not on the confrontation between George Bush and Mr Chávez, as some pundits claim.

One new trend will be more women at the top. In Chile, Michelle Bachelet will probably be taken to a run-off, but still seems certain to land a fourth consecutive term for the centre-left Concertación coalition. Her victory could help Lourdes Flores, a conservative, in Peru. A second, already established trend is likely to mean that most of the victorious presidents will be relatively weak, lacking majorities in fragmented congresses. There will be strongmen: Mr Chávez looks certain to be re-elected next year, as does Álvaro Uribe, a tough conservative democrat, in Colombia. But those who foresaw powerful presidents riding roughshod over Latin America's restored democracies have on the whole been proved wrong and are likely to be so again.

In Brazil, Luiz Inácio Lula da Silva may manage to secure a second term, despite the corruption allegations against his government, though he could be strongly pressed by the man he beat last time, José Serra (assuming he decides to stand). Mr Serra, the mayor of São Paulo, is from the centrist Party of Brazilian Social Democracy of Fernando Henrique Cardoso, a former president. But even if Lula does win, his left-wing Workers' Party, badly tarnished by a party-financing scandal, is bound to emerge weakened, obliging Lula to form a genuine coalition government.

Mexico's election may well be the tightest of the lot. Andrés Manuel López Obrador, the former mayor of Mexico City, remains the man to beat. He cut his political teeth in the long-ruling Institutional Revolutionary Party (PRI), though he now represents a leftish offshoot. As well as from the PRI itself, Mr López Obrador faces a tough challenge from Felipe Caldéron, a moderate conservative democrat. Mr Calderón will try to revive the appetite for change embodied in President Vicente Fox's historic defeat of the PRI in 2000. But whoever wins, Mexico's Congress is likely to remain split three ways.

The main challenge to the moderate-left policy consensus comes not from the right, but from radical populism. That is particularly strong in countries with abundant natural resources (Bolivia, Ecuador and Venezuela), or which have declined from a happier past (Argentina, Venezuela). In

such places, voters seem easily persuaded by charismatic leaders that their woes stem from exploitative foreigners or a corrupt traditional elite.

Bolivia's election, on December 18th, is being especially closely watched in Washington, DC. Opinion polls give around 33% of the vote to Evo Morales—the leader of the coca workers, a friend of Mr Chávez and a representative of Bolivia's indigenous majority. If no candidate gains an outright majority, the new Congress must choose between the top two. In the event of a Morales victory, the stage may be set for an ugly confrontation, with the United States branding Bolivia a "narco state" and Mr Chávez showering it with petro-dollars. Mr Morales's best chance of survival might be an alliance with Brazil and Argentina. In Nicaragua, Daniel Ortega, another American foe and leader of the Sandinista revolution, may win office again. But polls suggest that one of a couple of moderate centrists could end a quarter-century duopoly of Liberals and Sandinistas—provided they can get on the ballot.

Although Bolivia and Nicaragua will grab headlines, the contests that matter most are in Brazil and Mexico. In Brazil, Anthony Garotinho, a former governor of Rio de Janeiro, will mount a populist challenge. In Mexico, Mr López Obrador's populist instincts would be restrained by the North American Free-Trade Agreement and Mexico's increasing convergence with the United States. In the end, the region's political complexion may turn on a few million votes in those two countries. If Mr Calderón and Mr Serra win, the verdict will be that the tide has begun to turn against the left. Not so if the victors are Lula and Mr López Obrador.

The plethora of upcoming polls shows how routine democracy has become in this once dictatorship-ridden region. Electoral fraud is now the exception rather than the rule: only in Venezuela and, perhaps, Mexico are the losers likely to cry foul. But other procedural aspects of democracy need attention. Political parties tend to be weak. In some cases, electoral systems encourage fragmentation. In others, there are artificial restrictions on participation. Meanwhile, elections are growing increasingly expensive, but few countries have grappled effectively with campaign financing.

Despite all the problems, however, democracy is steadily "putting down roots" in Latin America, as Mr Cardoso has said. There are signs in some countries that presidents and legislatures are more prepared to seek consensus across party lines. The question is whether democratic muddling-through is enough. If Latin America is to match the growth rates of many Asian countries, another bout of reform will be required.

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Economist.com WORLD LATIN AMERICA

Retiring Americans

Go south, old man

Nov 24th 2005 | SAN MIGUEL DE ALLENDE
From The Economist print edition

The gringos are moving where the living is easy

YOU CAN'T really tell you're in Mexico. The menu is in English, so is the music, and seemingly every patron in the place is American—many of them extended families come together to celebrate Thanksgiving. San Miguel, a hillside town three hours north of Mexico City, has long played host to a community of expatriates from the United States, many of whom have chosen to retire there for all or part of the year. Although neither the Mexican government nor the American one keeps statistics on the town's foreign population, anecdotal evidence suggests that it is now growing at a faster pace than ever.

Joannie Barcal of Allende Properties, an estate agent from California, who has lived in the town for 16 years, says that the number of foreigners looking for houses in San Miguel has increased hugely over the past year. It is a comfortable sort of place—one might describe it as the opposite of bohemian. Trinket shops sell silver plates embossed with the logos of Louisiana State University and the University of Texas. The houses bought by foreigners are rarely cheaper than $220,000; several go for over a million every year, Ms Barcal says.

Many of the American settlers barely speak a word of Spanish. They move south not so much in pursuit of the sun, which they could find just as easily in Florida or Arizona, but in a search for a cheaper way of life, along with the sense of community that foreign enclaves generate. Estimates for the number of Americans of non-Mexican ethnicity who have retired to Mexico, mostly in San Miguel and a handful of other towns, hover around 250,000, with at least as many Americans with Mexican roots more widely dispersed. But the house-price boom they and other foreigners, notably Canadians, have created is now driving others even farther south.

Panama, Costa Rica, Nicaragua and Honduras all offer tax breaks to foreigners seeking to retire there. Beachfront developments catering for pensioners have sprung up along both the Atlantic and Pacific coasts, with a house right on the beach often costing just half what you could expect to pay in San Miguel, smack in the middle of Mexico. Even an influx of a few tens of thousands of American “senior citizens” can have a big impact on the small economies of the Central American countries. And the numbers could grow even bigger if America agreed to change its public health-care system for those over 65.

At present, Medicare, as the system is called, cannot be claimed abroad. So American pensioners tend to travel back to the United States to get treatment. The possibility of making Medicare “portable” has been talked about for years. But, apart from the introduction of a small pilot project, it has never got much further than just an idea. Yet the advantages are clear: expatriate pensioners would find it easier to get health care; the costs for the crisis-ridden Medicare would be lessened; and Mexico and other Central American countries with American pensioners would benefit not only from a rise in their health-care expenditure, but also from the big increase in their numbers that such a change would certainly bring.

Economist.com WORLD ASIA

Vietnam

Changing gear

Nov 24th 2005 | HANOI
From The Economist print edition

Reuters

Decent reforms are enriching the Vietnamese; the future looks fine

UNTIL recently, economists used to marvel at the speed with which the Vietnamese were trading in their bicycles for motorcycles. But that trend now seems out-of-date. Observers are now mesmerised by Vietnam's equally rapid embrace of the motor car. In the year to August, the local car industry's output grew by 43%. Private cars, their horns blaring in the hope of parting the sea of motorcycles, are suddenly a common sight on the streets of Hanoi and Ho Chi Minh City.

Like Vietnam's new car owners, the country's economy is accelerating, even as the rest of South-East Asia slows. In the first three-quarters of the year, it grew at an annual rate of 8.1%—faster than its five-year average of 7.2%. Better yet, Vietnam's poverty rate is falling almost as fast as its economy grows. The proportion of the population that the government deems poor fell from 58% in 1993 to 20% last year. If the reduction continues at the current rate, says Martin Rama, the World Bank's chief economist in Vietnam, abject poverty will soon be limited to ethnic minorities in remote areas.

This rapid growth, explains Jonathan Pincus of the United Nations Development Programme, derives chiefly from the steady shift of millions of inefficient subsistence farmers into marginally more productive pursuits. Many have begun growing coffee or farming prawns, while others now work in textile plants or shoe factories. Tens of thousands of family firms have also sprung up since 2001, when the government eased restrictions on small businesses. Since some 74% of Vietnam's 84m inhabitants still live in the countryside, and most of those remain rice farmers, there is plenty more scope for growth.

This virtuous cycle seems unstoppable. Successive outbreaks of SARS, a respiratory disease, and avian influenza, which has killed lots of birds and a handful of people, barely registered. The high oil price has had little effect, since Vietnam is a big oil exporter. The economy even seems to have

benefited from jitters about terrorism, since the same repressive regime that props up the country's Communist leaders also instils investors and tourists with a sense of security.

There are problems, of course. The authorities have recently conceded that Vietnam will not join the World Trade Organisation this year, as they had hoped. Indeed, Vietnam is in the midst of trade disputes with both the United States and the European Union. It stands accused of exporting everything from catfish to bicycles at predatory prices. But Vietnamese exporters seem remarkably adaptable. Shrimp and textiles that are being taxed by America have been diverted to Europe instead. Farmers who suffered when the international coffee price fell (thanks largely to a huge leap in Vietnam's output) are shifting to cocoa and pepper. Exports continue to grow at a steady clip of 20% or so a year. Seen in that light, Vietnam's many trade disputes are not so much a concern as a heartening indication of how competitive the country's exports are.

Observers also worry about Vietnam's banks. The biggest are state-owned, and operated murkily. Loans grew by 42% last year, largely given to other state-owned firms and local authorities. Earlier this year the central bank adopted stricter rules on loan classification, but the results are not yet clear. Foreign banks operate under severe restrictions—one of the main bones of contention in Vietnam's bid for WTO membership. Stock and bond markets are also in their infancy, although the government did issue its first international bond earlier this month.

All this makes it difficult for small businesses to raise money. Most family firms rely on personal savings or remittances from relatives abroad, amounting to $3.2 billion last year. Economists complain that Vietnam has plenty of tiny mom-and-pop outfits and big state-owned or foreign-invested firms, but nothing in between.

That does not seem to bother the government, which is keen to retain control of the commanding heights of the economy. It is planning big investments in petrochemicals and other heavy industries. The proceeds from the bond issue will be put towards assorted business ventures. But though the government continues to “equitise” (meaning privatise) state-owned firms, the pace is agonisingly slow. It recently announced that it would start selling shares in one of its four banks—but not a controlling stake, and only in small instalments spread out over five years.

The ultimate goal seems to be a web of partially privatised companies, subject to a certain degree of competition and market discipline, akin to Singapore's government-linked companies. Temasek, one of the Singaporean government's holding firms, has established an office in Ho Chi Minh City and has invested in one of Vietnam's two state-owned airlines.

The obvious drawback of this strategy is that Vietnam is a much more corrupt and inefficient place than Singapore. Singaporean officials argue that their country's tiny size and limited workforce necessitate a state-led industrial policy. But the same could not possibly be said of Vietnam. It would be better, perhaps, to leave the entrepreneurs of Hanoi and Ho Chi Minh City to drive the economy, as well as their shiny new cars.

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Sri Lanka

Tigers and a hawk

Nov 24th 2005 | COLOMBO
From The Economist print edition

A new president faces old dilemmas in pursuing peace

Get article background

AP

Rajapakse: a happy hawk

ANY election in Sri Lanka is in part a referendum on how to bring a permanent end to the country's civil war, which began in 1983. In that context, the outcome of the presidential poll on November 17th is, at first sight, worrying. The victor, Mahinda Rajapakse, prime minister under the outgoing president, Chandrika Kumaratunga, has a reputation as a hardline defender of the interests of the majority Sinhalese population. He has called for a renegotiation of the ceasefire between the government and the Liberation Tigers of Tamil Eelam, which has largely held since February 2002. Fears about his presidency mounted when he appointed Ratnasiri Wickremanayake, another hawk, as prime minister. But a return to full-scale war remains unlikely.

Despite his image, Mr Rajapakse has a record as a pragmatist. Moreover he has no clear mandate for a bellicose line. He won by just 180,786 votes out of nearly 10m cast. In fact, he owes his victory to the Tigers, who enforced an undeclared boycott in areas under their control. They have been fighting for an independent homeland in the north and east of the island for the Tamil minority. Tamils make up about a fifth of the population, and most of them, given the chance, would have voted for Mr Rajapakse's more doveish rival, Ranil Wickremesinghe.

Mr Wickremesinghe called for a rerun of the voting in the north and east of the island. An independent watchdog also concluded that free and fair voting had been impossible because of intimidation in the north, and a lack of access to transport in Tiger-controlled parts of the east. By Sri Lankan standards, however, this was a fairly peaceful election, despite a number of grenade attacks. The election commissioner rejected calls for another round of voting, and Mr Wickremesinghe was forced to accept the result.

He has, however, called it a severe setback for the peace process. During the election campaign, Mr Rajapakse forged an alliance with two parties advocating a much tougher line towards the Tigers: a Buddhist group led by monks, and the Janatha Vimukthi Peramuna (JVP), which mixes Marxism with Sinhalese chauvinism. Neither party, however, initially joined the new government. Analysts now expect an early parliamentary election, in an effort by Mr Rajapakse to lessen his dependence on his extremist allies.

The president himself has criticised the ceasefire, signed, after Norwegian mediation, when Mr Wickremesinghe was prime minister. He has attacked the role played by Norway, as too soft towards the Tigers. But Mr Rajapakse may find there is no alternative to western involvement, if the huge amounts of reconstruction aid on offer to Sri Lanka are not to be jeopardised.

The ceasefire has often appeared on the point of breaking down. A rebellion last year by a faction of the Tigers against the rule of its dictatorial leader, Velupillai Prabhakaran, was blamed by the Tigers on the Sri Lankan army, and has led to tit-for-tat killing ever since. This year, the two sides have squabbled bitterly over establishing a mechanism for distributing relief funds, donated after last December's devastating tsunami, in Tiger-controlled areas. And in August this year, Sri Lanka's foreign minister, Lakshman Kadirgamar, an ethnic Tamil reviled by the Tigers as a traitor, was assassinated.

But the Tigers have said they are not planning to go back to war. Rather, they seem to be hoping that a hardline government in the Sinhalese-dominated south will sway international opinion in their favour. So the status quo—neither peace nor war—is likely to persist. But the longer it does, the less it looks like peace.

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India

Caste out

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Long misruled, Bihar votes for change

Get article background

THE mystery is less that he lost the election by a thumping margin, but that he had held power for so long. Laloo Prasad Yadav and his party, the Rashtriya Janata Dal (RJD), had ruled Bihar, a state of 83m people, since 1990. In that time it set the standard for bad government. Kidnapping for ransom was the only growth industry. Poverty, illiteracy, corruption and violence thrived. Mr Yadav's belated comeuppance came in an election result announced on November 22nd that left the RJD with just 54 out of 243 seats in Bihar's legislative assembly. The newspapers in Delhi did nothing to disguise their glee. “Laloo loses; Bihar wins”, was one headline. Even the RJD's ally, the Congress party, may not be too upset by the defeat of the biggest of its coalition partners in the central government.

Mr Yadav, who stood down as Bihar's chief minister in 1997 in favour of his wife after being charged with corruption, is India's railway minister. His rise has been built on his skill at the politics of caste and religion. A former cowherd, he earthily flaunted his humble origins as proof of his ability to bring dignity to the lower castes; and, allied with powerful gangsters, he presented himself as a protector of the Muslim minority.

Only this year did this formula fail him, for a number of reasons. One was the job done by India's independent election commission, which kept the campaign relatively free of violence, and prevented “booth-capturing”—the coercion of voters. But this was also a rerun of an election held early this year, which resulted in a hung assembly. The decision to dissolve that assembly was ruled unconstitutional by the Supreme Court. There was anger in Bihar at the way the interim

period of central-government rule was manipulated by Mr Yadav in his own interest.

Moreover, others, such as Bihar's new chief minister, Nitish Kumar, of the Janata Dal (United), have learned the art of caste-coalition building. Mr Yadav was deserted by many former supporters. His disdain for development, which has seen Bihar fall further behind on most social indicators, was, eventually, his undoing. Nor do Muslims now feel so worried by the rise of the Bharatiya Janata Party (BJP), the main national opposition and Mr Kumar's partner, with its Hindu-nationalist ideology.

This is undoubtedly a setback for Congress and its ruling coalition, and a boost for the BJP. But Sonia Gandhi, Congress's leader, has pointed out that the previous government suffered a series of similar setbacks. In that it curbs the power of Mr Yadav, a demanding and rather embarrassing ally, this defeat may even have some benefits for her. The prime minister, Manmohan Singh, may also be able to see the bright side. “There is an India that wants to move ahead even faster,” he said in a speech last week. “There is an India that is unable to catch up.” Bihar may at last have its chance to try.

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Economist.com WORLD ASIA

Nepal

Three into two

Nov 24th 2005 | DELHI AND KATMANDU
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A novelty for King Gyanendra: a united opposition

THE battle-lines in Nepal's bitter triangular conflict have become clearer. After talks in Delhi last week, two of the three sides—the Maoist insurgents and the mainstream political parties—announced on November 22nd that they were ganging up on the third, the monarchy. King Gyanendra, who seized absolute power in February, is as isolated at home as he is unpopular with Nepal's main allies abroad. But he is still solidly in charge.

Ever since the royal coup, the Maoists, whose insurrection has cost more than 12,500 lives in the past nine years, have been edging closer to a coalition of seven democratic parties. The king has shunned dialogue with either the Maoists or the parties. Seeing a chance to move into the mainstream, the Maoists decided to pursue an alliance with the parties and, to build trust, declared a three-month unilateral ceasefire in September, which the army did not reciprocate. Analysts say that the insurgents recognise that it is not possible to overrun Katmandu, and may be looking for a “soft landing”. A steady trickle of guerrillas is surrendering to the army, suggesting morale is low.

The agreement with the parties calls for a boycott of the municipal elections that the king has called for next year, and the formation of a constituent assembly to draft a new constitution—with, presumably, no role for the monarchy, or only a ceremonial one. It also calls, “after bringing the autocratic monarchy to an end”, for supervision by the United Nations or another “reliable international body” of the Maoists' and Nepalese army's weapons.

Foreign governments—especially India's—are encouraged by the accord. But it does not herald an early end to Nepal's agony. Crucial disagreement remains. The parties want parliament reinstated and an all-party government formed to hold talks with the Maoists before a constituent assembly is formed. The Maoists, who are not in parliament, prefer a “national conference of all the democratic forces”.

More fundamentally, the king controls the army and the government, and holds the key to peace. If the Maoists return to violence, then the democratic parties will be in an uncomfortable position associating with them, as the government enforces “anti-terror” measures. If the Maoists remain at peace, then there is little need for the government to deal with them.

The parties and the Maoists may regard isolating the king and casting him as a warmonger, unwilling to negotiate, as an end in itself. It would certainly step up the international pressure on him. Cold-shouldered by India, however, he seems to be hoping China will come to his aid, and in public at least, is unperturbed. While his enemies plotted this political ambush, he was away on a two-week tour of African capitals. Perhaps he reasons that his position is safe. Another explanation is given credence in Katmandu: King Gyanendra, a pious Hindu known to believe in astrology, has a particularly felicitous horoscope at the moment.

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East Asian diplomacy

The case against summits

Nov 24th 2005 | BEIJING AND TOKYO
From The Economist print edition

Political limits to the region's economic aspirations

A GREAT display of unity marked the Asia-Pacific Economic Co-operation (APEC) summit in Pusan, South Korea, last weekend: the assembled leaders agreed that bird flu was a bad thing. Otherwise, the show was a depressing exercise. A welcome call was made for progress in the talks to liberalise world trade; and the assembled heads admonished Europe for showing no great readiness to slash farm protection. Yet APEC's motley bunch had no common proposals of their own for giving momentum to trade liberalisation before the crucial World Trade Organisation (WTO) talks due in December. And the criticism of Europe was mild.

Above all, a political spat between Japan and its neighbours over its wartime past brought home the limits to regional co-operation. South Korea's president, Roh Moo-hyun, delivered a finger-wagging lecture to Japan's prime minister, Junichiro Koizumi, about his visits to Tokyo's Yasukuni shrine, where some war criminals are honoured. China's president, Hu Jintao, refused to chat with Mr Koizumi on the sidelines. Packing an empty bag, Mr Koizumi returned to Tokyo to unveil the ruling Liberal Democratic Party's proposals for revising Japan's pacifist constitution. The new draft keeps the country's commitment to peace but asserts Japan's right to defend itself, use its armed forces to take part in international operations and even come to the aid of allies. The unveiling marks the beginning of a long and needed debate about Japan's “normalisation”. Yet the move is bound to provoke accusations from China of militarism on the rise.

Mr Koizumi also welcomed a visit by President Vladimir Putin of Russia. Unresolved wartime issues colour relations between these two countries, too, for in the last days of the second world war the Soviet Union seized four Kurile islands, known in Japan as the Northern Territories; and since they have not been returned, no border between Russia and Japan has been drawn nor peace treaty signed. When Mr Putin last visited Japan five years ago, differences were wide. This time, he was determined to talk only about business, and dragged along dozens of Russian executives. Mr Koizumi's reward was the tantalising promise of a pipeline running from oilfields in eastern Siberia to the Sea of Japan. Japan promised in return to back Russia's bid to join the WTO.

As for President George Bush, his APEC summit was not much better than Mr Koizumi's. His attention was continually distracted by the domestic fallout from Iraq. And, the day after Mr Bush had praised Mr Roh for having committed 3,200 troops in Iraq, helping “democracy flourish” in the Middle East, his hosts announced that a third of them were to be withdrawn. With a bitter taste, Mr Bush left for Beijing.

His visit to China was not meant to change the world. By the time he departed on November 21st for the first ever presidential trip to Mongolia—having met top Chinese leaders, attended a church service and, of all things, gone cycling with Chinese athletes—Mr Bush could fairly claim to have done what he came to do: keep things ticking along in what is perhaps becoming the world's most crucial bilateral relationship.

Mr Bush describes Sino-American relations as “complex”. The talks with Hu Jintao and the prime

minister, Wen Jiabao, covered a nuclear North Korea, the status of Taiwan and America's grievances over China's exchange-rate policy, its $200 billion annual trade surplus with America, violations of intellectual property rights and shoddy human-rights practices.

America evidently wants to tread more gingerly on matters of human rights these days. At any rate, says China's foreign-ministry spokesman, Kong Quan, human rights “made up a tiny, tiny, tiny part” of the meetings. Mr Bush urged China's leaders to allow greater religious and political freedom. Keen for its part to keep the visit friendly and business-like, China likewise offered measured responses. It also claimed progress on improving human rights, and vaguely promised more.

China gave similar promises, but no timetable, to make its currency more flexible. It also promised to buy 70 jets from Boeing over the next three years. None of this is earth-shaking stuff, but the tone of these meetings is increasingly mature. That is a virtue that China and Japan, to the detriment of the region's stability, have not found in their relations.

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Singapore

Cloudburst of ghoul-slayers

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From The Economist print edition

Geeks gather for the world gaming championships

IT WOULD be easy to dismiss the World Cyber Games (WCG) 2005, held last week in Singapore, as geek nirvana. Over 700 boys and men, and one woman, crossed swords over eight games, including Counter Strike: Source, Warhammer and StarCraft Brood War. Commentators, meanwhile, delivered lines such as: “He's opening up with his double blade master to harass some ghouls.” Yet the geeks tout some impressive figures. More than 1.25m people participated in qualifying tournaments in 67 countries, and the prize money, thanks to sponsorship from firms like Samsung and Intel, topped $2.5m.

The world's best players are treated like celebrities. In South Korea, internet-gaming stars earn six-figure dollar salaries, attend university on special gaming scholarships and have massive fan clubs—glued to the two cable channels dedicated to the sport. The sponsor of the defending StarCraft champion, Seo Ji Hoon, held a lottery to select 20 of his fans to be flown to Singapore to watch the competition.

The WCG is likely to get bigger. Industry research claims internet gaming overtook the film industry three years ago as the world's most popular entertainment medium, and the world's estimated 300m internet gamers—who are nearly all under 35 years old—will probably double in number in less than a decade. If heavily populated countries like China, India and Indonesia expand their broadband networks quickly, the 600-millionth player will emerge even sooner. Analysts say professional associations for players and competitions are but a few years away, while it will probably soon be the norm for schools to offer internet gaming as an alternative to more athletic sports.

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Israel

Ariel Sharon sets off on his own

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Getty Images

The prime minister has abandoned his own party and plunged Israeli politics into turmoil, and no one is sure of the outcome

ISRAEL-WATCHERS are scrambling for new geological metaphors. If Amir Peretz's victory over Israel's elder statesman, Shimon Peres, for the leadership of the Labour Party earlier this month was an “earthquake”, as some called it, then what is the even bigger upheaval that has now been caused by Ariel Sharon, the prime minister? This week he quit the Likud, the party he helped found 32 years ago. In a general election now due on March 28th, he will run at the head of a new centrist party called Kadima (meaning “Forward”). Opinion polls this week suggested he might win 30-33 seats in the 120-member Knesset, Israel's parliament, more than either Labour (26) or Likud (12-15). Perhaps that is just the novelty value. Other projections just before his move put any new Sharon-led party in third place.

Mr Sharon's close advisers, says one of them, Eyal Arad, had agreed that staying in the Likud would have been a safer bet. The challenge from his erstwhile finance minister, Binyamin Netanyahu, who had joined a rebellion within the Likud against Mr Sharon's withdrawal of Israeli settlers and soldiers from the Gaza strip and then, after the withdrawal, bid for Likud's leadership, had evaporated. And when Labour chose Mr Peretz, a firebrand leftist, it arguably fortified Mr Sharon, who within the Likud is a relative moderate.

But the dozen-odd rebel Likud parliamentarians had continued to make Mr Sharon's life “insufferable”, he said this week, most recently by blocking some ministerial appointments. And in any case, says Mr Arad, the split between pragmatists like Mr Sharon, for whom settlements are

chiefly a means to Israel's security (and can be sacrificed if it seems to serve the same end), and Greater Israel ideologues, for whom they had become essential to the Jewish state, had been widening for years. Had Mr Sharon stayed, he would have struggled to keep his fractious party both whole and obedient, while competing with Mr Peretz in wooing smaller parties to get the 61 seats needed for a governing coalition.

And so the man known as “the bulldozer” for his method of negotiating the obstacle courses of Israeli politics decided to bulldoze a new course for himself instead. So far, Kadima is made up of around 14 ex-Likud loyalists. It may lure defectors from Labour too: Haim Ramon, a Labour man who is a minister in the present coalition cabinet, has joined already. Several prominent non-politicians are expected to enter politics under the new party's banner, though that could be a problem if Mr Sharon ends up with more wannabe ministers than cabinet jobs. Opinion polls also suggest that he will draw centrist voters away not only from the Likud, which now faces an exhausting and divisive leadership battle, and Labour, but also from many of the smaller parties.

So even if Kadima fails to come in first, there can probably be no coalition without it. It holds the centre ground between two harsh extremes. In the red corner is Mr Peretz, who advocates immediate talks on a Palestinian state and aggressive increases in social spending. In the blue corner, a rump Likud made up of expansionist hawks and free-marketeers like Mr Netanyahu, whose policies as finance minister did much to alienate the poor and make Labour's members vote for Mr Peretz. The idea of these two forming a coalition just to spite and exclude Mr Sharon seems laughable. He should be at least a kingmaker, if not king, though several right-wing religious parties have now started feverish talks on forming their own united block.

But what will his party stand for? Since Mr Peretz took over Labour, politicians have been changing their manifestos as often as their socks in attempts to outdo each other. Mr Sharon has suddenly embraced the war on poverty. So have two Likud ministers planning to challenge Mr Netanyahu for the leadership. Mr Peretz, after a maiden speech as leader that was tub-thumpingly pro-peace, now cleaves with hoarse fervour to the Sharon-beloved ideals of an undivided Jerusalem and no right of return for Palestinian refugees to Israel proper.

Once the dust settles, though, it is likely that Kadima will campaign on standard vote-winners: social justice on the one hand, and security (ie, the Palestinian Authority must wipe out terrorism) as a precondition for peace talks, on the other. How Mr Sharon might reconcile that with Mr Peretz's more doveish approach is anybody's guess. But with so much having changed in the past fortnight, it is plain that everything, over the next four months, is up for grabs.

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Iran

He's even stirring up the oil ministry

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From The Economist print edition

President Mahmoud Ahmadinejad wants to shake up everything

HE PLEDGES to lay low those “aristocrats” who sit on a dozen managing boards, default with impunity on loans from public banks and drive armour-plated cars worth $300,000. But the fight picked by Iran's fiery president, Mahmoud Ahmadinejad, will be hard to win—not least because, in Iran's semi-socialist economy, the line between entrepreneur and civil servant is all but invisible and the rot so pervasive. He has already made an enemy of the architect of many of these ambiguities, Akbar Hashemi Rafsanjani, who selectively liberalised the economy when he was president in the 1990s.

Early this month, Mr Ahmadinejad sacked the bosses of seven of the big public banks that have extended, so he says, 60% of their loan facilities to a privileged 4% of Iranians. He claims to have a “long list” of people who have “dipped into the public purse” but declines Mr Rafsanjani's invitation to reveal it. Most worrying for the president, three months into his tenure, he does not have a grip on the oil ministry, the linchpin of the system he detests.

Here, Mr Rafsanjani, a grandee who retains much influence over the ministry, has been helped by parliament, which also gets on badly with the new president. This autumn, deputies have withheld votes of confidence in Mr Ahmadinejad's successive nominees to be oil minister; this week they rejected Mohsen Tasalloti, his third choice. One top oil official criticised the government's plans to spend $3 billion of oil revenues to buy petrol, of which Iran consumes far more than it produces, and its refusal to stop subsidising prices at the pump. Another questioned the existence of what the president calls the “oil mafia”.

In a hydrocarbon-reliant country that Transparency International, a Berlin-based anti-corruption lobby, considers to have a “serious corruption problem”, it would be a surprise if Iran's oil industry were squeaky clean; in 2003, some top people in Norway's Statoil resigned after it emerged that the company had paid bribes to win the right to develop an Iranian oil field. Still, for all the rumours of rigged tenders, there have been, tellingly, no high-profile court cases in Iran. The industry is enfeebled by American sanctions and politicians' antipathy to foreign investors. Scandal is the last thing it needs.

According to a recent report by the International Energy Agency, Iran's oil industry must attract some $80 billion in investment over the next 25 years if it is to meet soaring domestic energy demand and remain a major exporter. Its fledgling gas export industry needs a similar injection; though Iran has the world's second biggest reserves, it is a net importer. But foreign deals need strong leadership. Some putative ones, such as India's plan to buy liquefied gas and develop an oil field, are mired in politics and small print.

Mr Ahmadinejad says he wants to bring Iran's oil lucre to the “dining table of the people”. Not if he can't find a new oil minister.

Women in a dangerous world

No place for your daughters

Nov 24th 2005
From The Economist print edition

Counting the victims

TUNING in round the clock, via satellite or internet blog, to any bout of mayhem anywhere, you might not think the world was becoming a more peaceable place. But in some ways it is, and measurably so. A recent Human Security Report released by the Liu Institute at the University of British Columbia registers a 40% drop in the number of armed conflicts between 1992 and 2003, with the worst wars, those claiming more than a thousand lives in battle, down by 80%. While 28 armed struggles for self-determination ignited or reignited between 1991 and 2004, an encouraging 43 others were contained or doused.

Yet measured in a different way, from the point of view of the half of the world's population that is female, argues the Geneva Centre for the Democratic Control of the Armed Forces, the world is an awfully violent place, and not just in its war zones. Men still fill most of the bodybags in wartime, including in civil wars, even on DCAF's figures, but their sisters, mothers, wives and daughters, it argues in a new report entitled “Women in an Insecure World”, face nothing short of a “hidden gendercide”.

Violence against women is nothing new. DCAF's contribution is to collate the many figures and estimates—not all of them easily verifiable, it has to be said—on everything from infanticide to rape (in both war and peace), dowry deaths, sex trafficking and domestic violence (in richer countries as well as poorer ones).

According to one UN estimate cited by DCAF, between 113m and 200m women are now demographically “missing”. This gender gap is a result of the aborting of girl foetuses and infanticide in countries where boys are preferred; lack of food and medical attention that goes instead to brothers, fathers, husbands and sons; so-called “honour killings” and dowry deaths; and other sorts of domestic violence. It implies that each year between 1.5m and 3m women and girls are lost to gender-based violence. In other words, every two to four years the world looks away from a victim count on the scale of Hitler's Holocaust.

Women between the ages of 15 and 44 are more likely to be maimed or die from violence inflicted one way or another by their menfolk than through cancer, malaria, traffic accidents or war combined. Poor health care means that 600,000 women are lost each year to childbirth (a toll roughly equal annually to that of the Rwandan genocide). The World Health Organisation estimates that 6,000 girls a day (more than 2m a year), mostly in the poor world, undergo genital mutilation. Other WHO figures suggest that, around the world, one woman in five is likely to be a victim of rape or attempted rape in her lifetime.

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Kenya

The future is Orange

Nov 24th 2005 | NAIROBI
From The Economist print edition

Old tribal divisions trump a proposed new constitution

Get article background

EPA

Oranges beat bananas

FOR months, Kenyans had pored gamely over the 200-page draft of a new constitution put forward by President Mwai Kibaki's government. This week, after a furious national debate, Kenyans rejected it by a decisive 57-43% margin, so they are left with the same old document the departing British bequeathed them in 1963.

It was largely a protest vote against Mr Kibaki. It certainly leaves his authority diminished—which, ironically, is rather what he said he was campaigning for all along, proposing a new post of prime minister. But, more dangerously, the debate sharpened old tribal and regional grudges, polarising the country between “Bananas” (yes) and “Oranges” (no), the symbols used to help illiterate voters. MPs punched each other in the face and at least 24 people were killed in protests, some shot dead by the police at rallies. The cabinet split so bitterly, with seven ministers joining the opposition campaign, that it has hardly met since July.

Mr Kibaki, the lead Banana, spent a lot of state and other money promoting the new constitution. He bought off key tribal constituencies with land grants, new district boundaries, concessions to sugar farmers and so on. In the end, he had to rely almost entirely on his Kikuyu tribe, the biggest in the country, for the yes vote. To Mr Kibaki's credit, the poll was fairly clean and peaceful, and he conceded defeat quickly and graciously.

The Oranges were savvier. They borrowed a British company's advertising slogan, “The Future Is Orange”, and convinced voters in western Kenya, on the coast and in the Nairobi slums that in fact Mr Kibaki was pushing for a still stronger presidency and more central control that would make the Nairobi elite and the Kikuyus more dominant. Areas of the country inhabited by the Luhya, Luo, Kalenjin and Kamba groups overwhelmingly voted no.

The big Oranges—Raila Odinga, a leading Luo from western Kenya who is the roads minister, and Uhuru Kenyatta, a son of the founding president—are now well-placed for a tilt at the presidency in 2007. Mr Kibaki had promised to fire Mr Odinga, and the other cabinet ministers who defected to Orange, in the event of a Banana victory. Instead, two days after the referendum vote, he sacked his entire cabinet.

Messrs Odinga and Kenyatta are awkward bedfellows, both ambitious and both wishing to give their rival supporters a bigger piece of the pie. The problem is that the Kenyan pie, never large enough, is getting smaller. Economic growth of 5% this year, and the same projected for next, will not match the country's population growth; Kenya may have more than 40m people by 2015, up

from 3m a century ago, 9m at independence and 32m or so today. As much as anything, this week's message to Mr Kibaki was that a better constitution might be nice but the people would prefer the more mundane things he originally promised them when he was elected in 2002: more jobs and less corruption.

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Uganda

Going on and on

Nov 24th 2005 | KAMPALA
From The Economist print edition

President Yoweri Museveni clears the way for next year's election

EARLIER this year, Yoweri Museveni amended the constitution to lift the term limits that would have required him to step down next year. Then, last week, he announced that he would stand for office, yet again, in the election due in March. Having seized power after a guerrilla war in 1986, it looks as if he will easily outpace other regional colleagues, such as Kenya's Daniel arap Moi (who retired in 2002 after 24 years) and Tanzania's Benjamin Mkapa, due to bow out this year after his constitutional maximum of two terms in office.

Just to make things easier for Mr Museveni, the government has already locked up Kizza Besigye, the man who might yet cause him some problems next year. Once Mr Museveni's doctor, he had returned from exile to Uganda last month to contest the presidency. But he was quickly arrested on a charge of treason, which carries a death sentence, after being accused of plotting with a rebel group to overthrow the government.

But perhaps Mr Besigye's bigger crime was his obvious popularity when he returned to Uganda. He has challenged Mr Museveni once before, in 2001, and did rather well. Officially, he got 27% of the vote to the president's 69%, but some observers think he really got as much as 42%, despite all the incumbent president's advantages. That was enough to give Mr Museveni quite a fright. Fearing for his safety, Mr Besigye fled to South Africa.

His homecoming unquestionably pepped up his party, the Forum for Democratic Change, and the growing number of people disenchanted with Mr Museveni's increasingly authoritarian rule. When the Forum went out on the campaign trail, it drew big crowds in the north, the West Nile region and in the west, which is Mr Museveni's base. The high turnout seems to have rattled the government and forced the president's hand. “Museveni fears people he thinks can defeat him,” says Wafula Ogutu, once a Museveni supporter, now with the Forum.

The government can keep Mr Besigye in jail for up to 360 days, if it wants. After his arrest, some of Mr Besigye's supporters rioted for two days in the centre of Kampala, the capital, and the police responded with rubber bullets and live rounds. Many Ugandans were particularly shocked by the deployment of black-shirted army commandos, labelled by the local media the “Black Mamba Urban Hit Squad”, outside the High Court during a bail hearing for Mr Besigye and some of his co-defendants. This reminded them of the notorious State Research Bureau, whose thugs entered the same court in 1972, in the days of Idi Amin's bloody presidency, and stuffed the chief justice into the boot of their car, after which he was never heard of again. Quite apart from the immediate fate of Mr Besigye, none of this bodes well for a free and fair election next year.

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The UN's Food and Agriculture Organisation

The boss hangs on

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A big UN body needs a bit of democracy

HE CAME to office when Bill Clinton was a new president. Last weekend, he was re-elected, unopposed, for a third six-year term. Jacques Diouf of Senegal does not rule a country. But as head of the UN's largest specialised agency, the Rome-based Food and Agriculture Organisation (FAO), he wields immense financial power in the poor world and is treated by many governments as a head of state. With a staff of over 3,000, the FAO spends some $375m a year. One of its many responsibilities is advising the world's governments on bird flu.

Mr Diouf's reappointment would have been more welcome if his organisation were not in crisis. But it is expected to have to borrow at least $80m this year, mainly because Japan withheld its subscription to mark its unease over the FAO's performance. The organisation's last big event, the Food Summit in 2002, was widely criticised. A British study this year concluded that the FAO was the second-most ineffective UN body out of 23 surveyed.

Perhaps the most damaging criticism of Mr Diouf came in May, when a fellow west African and former FAO official, Mahamadou Maïga, published an open letter in a Malian newspaper accusing the FAO boss of having an “undemocratic vision”. Essential policies, said Mr Maïga, had failed.

Mr Diouf is now at least showing an interest in reform. A plan he tabled at the weekend includes proposals for streamlining his outfit's administration. He has also dropped objections to an external evaluation. The FAO needs one.

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East European economies

East, west and the gap between

Nov 24th 2005 | TALLINN, VILNIUS AND WARSAW
From The Economist print edition

Assessing whether the poorest post-communist countries can ever catch up

A DOLLAR a day or less is the World Bank's standard definition of poverty. But in the cold ex-communist countries of central and eastern Europe, where more is needed for heating and clothes, $2.15 is the poverty line. Many people have now climbed above that level: between 1998 and 2003 alone, more than 40m moved out of poverty; 60m remain. The best performer, Hungary, has almost no people living in poverty; in the worst, Tajikistan, the figure is 70%. But the bigger question is which post-communist countries stand a chance of catching up with the rich world within a generation, and which will stay poor for the rest of the century.

The sunniest outlook is in the countries that have done best so far: the eight new members of the European Union, plus Croatia, which hopes to join soon. They have got two big things right. The first is openness to foreign trade, which is strongly associated with economic growth (see chart 1). Competition from foreign firms, whether at home or in export markets, sharply raises productivity.

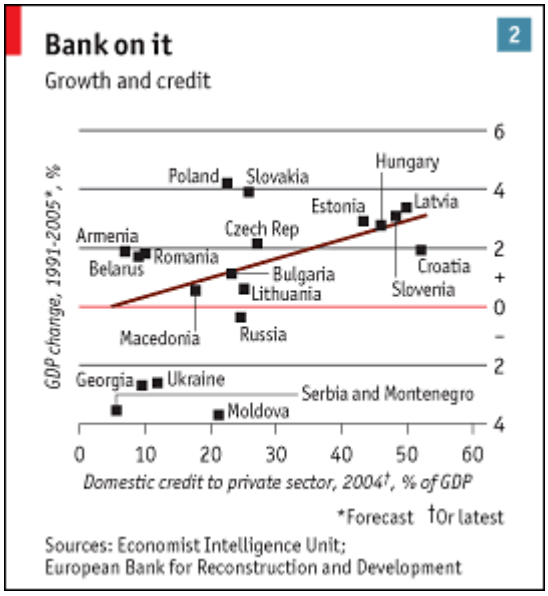
The second, harder to measure, is having the institutions to make capitalism work, create confidence, bust cartels, rein in greedy officials, enforce contracts and safeguard property. Why some countries are better at this than others is hotly debated. Steven Fries, of the European Bank for Reconstruction and Development (EBRD), highlights “political contestability and the rule of law”—when incompetent politicians and officials risk losing their jobs, and corrupt ones may go to jail.

Quantifying this is hard. One approach is to look at the banks, which flourish only when the right institutions are in place. Banking requires confidence among firms and lenders that the institutions that underpin the business environment are reliable. When it grows, it brings big benefits. Getting money out of suitcases and into bank accounts means that it can be lent and borrowed more efficiently. There is a strong correlation between the growth of credit and of the economy (see chart 2).

The countries of central Europe and the Baltic area have grown fast in the past ten years, and are starting to regain the ground lost under communism. Slovenia is richer even than Portugal, the poorest of the old EU members. The Baltics are growing at 8% a year or more. At that rate, their standard of living will double in a decade.

But the detailed scores in the EBRD's annual transition survey of the region's progress* show that even the best are only inching forward on what is called “economic governance”—customs and labour codes, tax and judicial systems, and so on. Slovakia is the only exception this year, with sharply improved scores on all fronts. “The big story in the region is that the private sector is really delivering the goods, both literally and figuratively,” says Mr Fries. “But the state sector's performance is lagging far behind.”

EU membership has boosted trade. That surprises observers such as Willem Buiter, the EBRD's former chief economist: “I thought the free-trade arrangements agreed in previous years had already exhausted the potential. But it seems that quite a few people were willing to make the necessary investments only when these countries were in the EU.”



But there are some negative effects. Estonia is widely regarded as a star. Mr Buiter terms it the “most competitive economy in the entire EU”. But it has had to adopt EU farm subsidies and protection. Estonia's previously liberal labour market, too, is scoring worse in the EBRD assessments—another side-effect of EU membership.

The wider effect of the EU on public administration is still unclear. It may have given bent bureaucrats more cause to worry about outside scrutiny. But others have found even more rules that they can use to extort money from hapless firms and individuals. “The rent-seeking industry has grown since we joined,” comments Ugnius Trumpa of Lithuania's Free Market Institute. He notes that new high tobacco prices set by the EU have been a huge windfall to local smugglers.

An even bigger difficulty is reforming the most complex bits of the public sector: health and education. Employers are increasingly complaining of labour shortages, especially skilled tradespeople and production workers. Along with labour regulations, employers say that skill shortages are the biggest problem they face. But the education system is not producing the right kind of workers. Indeed, it seems to be deteriorating. School scores, like health statistics, are

worsening, notes Mr Fries. These bits of the public sector are still rooted in communist-era thinking: inefficient, old-fashioned, largely immune from competition. In countries that have liberalised higher education, private-sector entrants have begun to make a difference. But schools almost everywhere still prize memorisation and regurgitation over critical thinking and creativity. That encourages cheating and corruption—and is bad for long-term competitiveness.

To be fair, even west European countries find reforming health and education very difficult. But the ex-captive nations do not have the luxury of time to dither about reform. They need growth and better public services to stop their best people emigrating and to end absolute poverty. They must improve their competitiveness if they are not to lose markets to rivals.

What about the even poorer countries farther east and south of the new EU members? There are a couple of bright spots. The 12 former Soviet republics are the fastest-growing bit of the ex-communist world. That is partly due to the windfall of high energy and commodity prices, and also because poor countries tend to grow faster. Unlike their richer counterparts, growth is creating more jobs than restructuring is destroying. The 12 are also doing better at keeping people in work. The poor are benefiting from the rebound more than the rich; wages and benefits may be meagre, but these are now mostly paid on time.

These modest pluses are, however, dwarfed by other problems. Public services are cash-strapped. Georgia spends under 1% of GDP on health; Croatia over 7%. Household utilities are becoming more costly as subsidies dwindle. In some countries, even such basics as water, electricity and universal education are starting to crumble.

The biggest immediate problem is a lack of good jobs. In Kirgizstan, for example, the share of workers in farming has shot up from 35% to 55% since 1990, as people have turned to semi-subsistence farming after jobs in industry vanished. In the Czech Republic, by contrast, it has fallen by more than half, to just 5%. World Bank statistics† show why new jobs aren't being created. Firms in the richer countries complain about an over-regulated labour market; in the poorer ones they worry less about the rules and more about corrupt bureaucrats who enforce them.

The debates about the economics of transition that raged in the mid-1990s are over. Few now seriously contest that macroeconomic stability, openness to trade, strong institutions and liberalised prices are preconditions for success. The trouble is that the countries most in need of faster reforms, more growth and better public services tend also to have weak institutions, bad geographical locations and unhelpful neighbours that give them the least chance of achieving success.

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*“Transition Report 2005: Business in Transition”, EBRD, London, £30.

†“Growth, Poverty and Inequality” and “Enhancing Job Opportunities”, World Bank, 2005.

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Economist.com WORLD EUROPE

Bosnia ten years on

Peaceful, rebuilt but still divided

Nov 24th 2005 | BANJA LUKA, SARAJEVO AND ZITOMISLIC
From The Economist print edition

Ten years after the Dayton accords, the testing ambition is to bring Bosnia and the rest of ex-Yugoslavia into the European Union

Not quite a powderkeg, not quite peace

IT IS a beautiful, sunny Sunday. The church door is open to all comers and the abbot of the little monastery is entertaining guests over cups of thick black Turkish coffee. In the fields, a couple of men are working; on the nearby road, a few cars pass on their way to the coast, perhaps families off to lunch by the seaside.

A normal enough scene, but one that tells an amazing story. It would have been unimaginable ten years ago, when the peace deal on Bosnia-Hercegovina was agreed on at an air base in Dayton, Ohio, on November 21st 1995, ending a war between Serbs, Croats and Muslims (known as Bosniaks), in which Serbia and Croatia had sought to carve up Bosnia. For the monastery is Serbian Orthodox, and it was left after Dayton in an area controlled by Croats and Bosniaks. In 1992, when the war began, the Serbs fled; their church, built in 1566, was blown up. The message was clear: “Don't return!” Yet some have.

The church, lovingly rebuilt, reopened in May. There are similar scenes across Bosnia. Catholic churches have been rebuilt in areas where Croats once lived. Hundreds of mosques, dynamited in Serb-controlled areas, have risen from the ruins. In Mostar, a few miles from Zitomislic, the Ottoman bridge, also built in 1566 but destroyed in fighting between Croats and Bosniaks in 1993, reopened last year.

Explaining the change of atmosphere which has allowed Serbs to return to Zitomislic, Abbot Danilo, aged 29, says simply: “We show that we are willing to live here, and people recognise

that." The rebuilding of the church is a poignant symbol.

But to build a country takes more than bricks, mortar and constitutions. In Bosnia, restored security and repaired roads have encouraged hundreds of thousands of refugees to return. Immediately after the Dayton deal, a NATO-led peacekeeping force of 60,000 troops took over the country. Today, only some 6,000 soldiers from an EU military force remain.

All Bosnians now share common passports. They can travel freely and safely wherever they want across the country. A single customs and border-police service staff the frontiers. Separate armies have been abolished. Next year a single VAT regime for the country will come into force. And on November 25th, the EU, recognising how far the country has come, plans to begin talks with Bosnia that could lead to its eventual accession.

From Dayton to Brussels

Bosnia has been transformed, but still has far to go. Dayton ended the war—but imposed a complex, costly system of government, dividing the country between a Serb part, the Republika Srpska, and a Bosniak-Croat federation, each with its own government. In addition, there is one autonomous district, belonging to neither. Central administration is weak.

On top of all this is the office of the high representative. Despite its neutral-sounding name, this hugely powerful position would once have been recognised as an imperial governorship. Lord Ashdown, a former leader of Britain's Liberal Democrats, is about to end three and a half years in the post. He can claim that, thanks to the forceful use of his powers (sacking intransigent elected officials, for example), he has led Bosnia "from Dayton to Brussels" (see article).

Foreigners are more impressed than the Bosnians themselves with all this. For them, change has been agonisingly slow. The economy—as far as statistics mean anything—remains weak. Unemployment stands at 43%. Dirk Reinermann of the World Bank argues that, if the grey economy is factored in, true unemployment is around 16-20%. However, he concedes that 18% of Bosnians live below the poverty line, and another 30% just above it.

Bosnian leaders are talking about revising the Dayton constitution. Under American pressure, the eight leading political parties signed a deal this week in Washington, DC, promising to make changes by next March. As it stands, the constitution cannot deliver an efficient government, nor can it bring the reforms needed for Bosnia to enter the EU. All parties agree it must be changed, but they have not yet been able to settle how.

Few Bosnians now fear that a new conflict might break out. Most Serbs and Croats who wanted to create a Greater Serbia and a Greater Croatia now recognise that Bosnia is here to stay. But they do not like it much. When Serbia beat Bosnia at football, young Serbs in the Republika Srpska came out to celebrate. The Bosnian flag, as opposed to the Serbian one, is rarely seen in Serb areas; the Bosnian Croat flag festoons Croat ones.

Some of the claims made for post-war Bosnia may be exaggerated too. Churches and mosques have been rebuilt but the number who have returned to territory controlled by former enemies is

not as impressive as it seems. Before the war, the Bosnian population was 4.4m. The war displaced some 2.2m, of whom 1.2m are believed to have gone abroad. Some 100,000 are thought to have died. Today the population may be 3.5m but it could be less (no post-war census has been held). The Bosnian foreign ministry thinks 300,000 Bosnians are now citizens of countries outside ex-Yugoslavia.

According to the UN refugee agency, just over a million displaced people have returned home, of whom 450,000 are so-called “minority returns”—for example, Bosniaks in the Republika Srpska, or Croats and Serbs in Bosniak-dominated Sarajevo. But there may have been fewer minority returns than the figures suggest. Many people “returned” only to regain possession of their property, which they then sold. Minority returnees may have stayed on in parts of the countryside but the towns and cities are overwhelmingly dominated by one or other ethnic group.

Drive through Bosnia at night and you notice something else. Much of the countryside is dark. Many people have repossessed and rebuilt their houses but no longer live there. Thanks to the war and its aftermath, their children have grown up in cities and do not want to live a tough rural life. In many cases, only elderly people have returned, and their families come back just for holidays. Although the post-war returns have dented ethnic cleansing, they have not reversed it. And the war accelerated the drift from country to town,

Mostar should be different: on paper, it is the only truly mixed Bosnian city. But few Serbs have returned, and Bosniaks now live on one side of town and Croats on the other. The dividing line is a street with two names: the Boulevard of Croatian Defenders, or of the People's Revolution. Yet to a foreigner the change in Mostar is palpable. Even four years ago, the atmosphere crackled with hate. Now that feeling has subsided. Since 2004, the administrations of Mostar's two halves have been merged. In the old Ottoman (now Bosniak) part of town, souvenir sellers say that, after the reconstruction of what is now called the “New-Old Bridge”, this year has been their best since before the war.

Yet schools are strictly divided on ethnic lines and people simply do not mix. In that sense, Mostar is a template for the rest of the country. Richard Williams, who has worked for Lord Ashdown in (re)uniting the city's administration, says that, having created the mechanisms to run one city, “it is up to the citizens of Mostar to carry those processes forward.” The same might be said of the country as a whole.

What of the common Bosnian institutions—including state border police, customs and a defence ministry—that have been created in the past few years? The good news is that they exist; the question is how real they are. Nerma Jelacic, the Sarajevo head of the Balkan Investigative Reporting Network, a news service, dismisses them as “Hollywood sets. They are two-dimensional and have no substance.” Senad Slatina, a political analyst, agrees: “they are so fragile that they would collapse in any tense situation.” Yet the movement towards EU integration is designed to lock the country into a process from which there is no return, in which what is now fragile becomes solid.

One problem is that this process cannot be completed without the arrests of Radovan Karadzic and Ratko Mladic, the Bosnian Serb wartime leaders, who are still at large a decade after having been indicted by the Yugoslav war-crimes tribunal. The EU has made clear that their arrest is a precondition for entry talks. In Washington this week, Bosnian leaders called for the two men to surrender.

Making the best of it, perhaps

Bitterness still bubbles beneath the surface. Yet in the words of Milos Solaja, head of the Centre

for International Relations in Banja Luka, in the Republika Srpska, “[Bosnia] is a country, like it or not. We live here and are citizens of Bosnia.” In Bosnia, even to say that is progress.

At its core, Dayton was a compromise. Bosnian Serbs were forced to give up their war aim of independence and union with Serbia. In exchange for autonomy within Bosnia, they agreed, reluctantly, that it should be a sovereign state. Now, ironically, as discussion focuses on how to reform Dayton, the Bosnian Serbs are its staunchest defenders. Not so Bosnian Croats, a minority in the Croat-Bosniak federation, who feel squeezed between Serbs and Bosniaks. Of Bosnia's pre-war Croat population of some 830,000, only half remain. Many, especially the young, have gone to Croatia, which, since independence, has offered them automatic citizenship. Some Bosnian Croats demand a “third entity” for Croats, but it is a demand that stands no chance of success.

Since 1999, with the death of the then Croatian president, Franjo Tudjman, Bosnian Croats have seen their support from Croatia, financially and politically, cut drastically. The reason is that Croatia's leaders made a strategic decision: that accession to the EU is more important than Greater Croatia. Serbia's leaders, too, have come to the same conclusion.

With both Croatia and Serbia in talks, albeit at different stages, with the EU on eventual accession, Bosnia's borders are (mostly) no longer contested. Hence, says Osman Topcagic, head of Bosnia's Directorate for European Integration, the EU should see his country as an “economic development and transition issue”, rather than a “political and security problem”. Apart from keeping a beady eye on a few Islamic radicals, he is probably right. But several problems loom for the coming year, many to do with the neighbours.

Trouble in the neighbourhood

Croatia is on track to follow Slovenia into the EU and NATO. Macedonia is also set to be given EU candidate-status in mid-December, an achievement which is designed to lock its Macedonian and minority ethnic-Albanian leaders into a process that should stop any return to the inter-ethnic violence of 2001.

But problems for the region still flow from the final acts of the drama of Yugoslavia's disintegration. The lesser of two great unsolved issues is the relationship between Serbia and Montenegro. The two states remain locked in a “state union”, although the two function more or less independently of each other. Serbia has a population of 7.5m; Montenegro only 650,000. Yet Montenegro's government is determined to hold a referendum on independence next year. If it passes, a new state will be born, albeit supported only by a slim majority of its citizens.

The worst unresolved legacy is Kosovo. Of its 2m people, well over 90% are ethnic Albanians who want full independence. Technically Kosovo remains linked to Serbia but, since the end of the war there in 1999, it has been under UN jurisdiction. Now, talks on its future status are starting, led by Martti Ahtisaari, a Finnish ex-president. Serbia's leaders say Kosovo can have “more than autonomy, less than independence”. But the talks will probably end with Kosovo getting so-called “conditional independence”. This would include a role for a Bosnian-style High Representative, although with a smaller mandate. Between now and then, violence is a real risk. Some Serb leaders, in Serbia and in Bosnia, hint that if Serbia loses Kosovo, it should be compensated with the Republika Srpska. They know this won't happen, but by making the demand, they may hope to get concessions over Kosovo or Bosnia.

Ten years after Dayton, many in former Yugoslavia are still gloomy. The region suffers from low standards of living and a serious brain drain, and frustration is widespread. Yet it is slowly progressing towards EU membership. And if the church at Zitomislic is anything to go by, what was once unimaginable may yet be possible.

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Bosnia's political culture

Blame it on Paddy

Nov 24th 2005 | MOSTAR AND SARAJEVO
From The Economist print edition

Trained by the centuries not to take decisions

AFP

Call me Pasha

"WE IN the international community must now begin to move from heavyweight, intrusive interventions to a new role of adviser, persuader and partner." So says Lord (Paddy) Ashdown. Like most policymakers who deal with Bosnia, and a growing number of locals, he believes it is high time for Bosnians to take responsibility for their own affairs. The hope is that his powers as high representative will be used less and less often, and that Bosnians can be nudged into making more of their own decisions.

On November 25th, Bosnia is due to start talks with the EU about the first steps on the path to eventual accession. Early next year, Lord Ashdown will step down. His successor is expected to be Christian Schwarz-Schilling, a former German minister and Bosnia hand who favours handing full powers back soon.

The high representative is also the EU's special representative in Bosnia. It is hoped that, over the years, EU conditionality can be used to keep Bosnia, like other countries in the region, on course towards stable prosperity.

Some westerners are uncomfortable over the vice-regal role the high representative has played. They wonder whether such a colonial institution is appropriate in 2005. Yet the past ten years have shown that Bosnia's problem is not just the legacy of a brutal war, but also a culture of deference. The origins of this phenomenon lie in the distant past.

For many Bosnians, it seems natural for a high representative to give orders to their leaders. That is, after all, how Bosnia has been ruled since the Ottoman conquest in 1463.

From then until 1878, Bosnia was ruled by a pasha sent by the Sultan from Istanbul. Between 1878 and 1918, it was governed by a representative of the Austro-Hungarian Empire sent from Vienna. From 1918 to 1992, the buck stopped in Belgrade. Now the high representative rules with orders given in Brussels, which has become Bosnia's latest imperial capital.

Two years ago the EU told the Bosnians to do 16 things before they could start talks on eventual accession. With much cajoling and bullying from Lord Ashdown, all were done by last month. Few believe that anything would have been achieved without him. Indeed Bosnian politicians like the role he has played, because it means they never have to take unpopular decisions. Sometimes they even ask him to impose decisions, knowing that, to their own voters, they can "blame it on Paddy".

French Socialists

To the barricades

Nov 24th 2005 | PARIS
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Reuters

A deeper shade of red: fulminating Fabius

The French Socialist Party lurches left

Get article background

A FEW months ago, France's Socialist grandees talked of a split in the 100-year-old party. The left was in disarray after a breakaway camp, led by Laurent Fabius, campaigned against the European constitution. Mr Fabius was unceremoniously dumped from the leadership. Yet this week, after a congress in Le Mans, the party rallied behind its leader, François Hollande. It produced a common policy platform, and welcomed Mr Fabius back on board. “The time for confrontation between Socialists”, declared a beaming Mr Hollande, “is over.”

This is the first time the party has produced a common programme since 1990, back in the days of François Mitterrand. This time, Mr Hollande was under huge pressure to match that achievement. The Socialists know their party's image has been tarnished by internal rivalries. During the recent riots, navel-gazing looked particularly inappropriate. A poll in *Le Monde* ahead of the Le Mans meeting suggested that 60% of French people gave the party no chance of winning the 2007 presidential election.

Yet unity has a price. For one thing, the party's modernising wing, led by Mr Hollande and such figures as Dominique Strauss-Kahn, Jack Lang and Ségolène Royal, has had to swallow policies inspired by the left. The programme would renationalise Electricité de France, the power utility, partly floated this week; raise the minimum wage; abolish flexible two-year job contracts; and boost overtime pay for working more than 35 hours. On the EU, the party has fudged matters, calling for a federal Europe that is both “more political and more social”.

Moreover, the battle for control of the party has been postponed, not resolved. Mr Hollande's stature may have grown after a successful congress, but many do not consider him a credible presidential candidate. He lacks charisma, has no ministerial experience, and, unlike his hugely

popular partner, Ms Royal, he gets poor poll ratings. The party is cursed by a wealth of presidential hopefuls. But the battle to watch, ahead of a vote next November to pick a candidate, concerns the Hollande-Royal couple and two heavyweights: Mr Fabius and Mr Strauss-Kahn.

For Mr Strauss-Kahn, it is awkward to be yoked to a policy platform so far to his left. As finance minister in the late 1990s, he privatised swathes of French companies. Lefty critics insult him with the Blairite label *social libéral*. He accepted the party's lurch to the left because, says one friend, “he had no choice”. The party had decided to set policy before picking a candidate, and the need for unity prevailed.

For his part, Mr Fabius emerges stronger from Le Mans than might appear. In a first round of voting, his proposals won only 21% of the vote, next to 54% for Mr Hollande's. Yet Mr Hollande's score is shared with Mr Strauss-Kahn and a handful of others. Moreover, by backing the single platform, Mr Fabius secured both his return to the party's leadership—he is expected to install a lieutenant in the executive rather than take a seat himself—and a more left-wing flavour for the party. It would not be a total surprise if he were to win the nomination next year.

As the left elsewhere in Europe modernises, the radical shift of France's Socialists looks odd. But it matches the country's anti-capitalist mood. Take the strike this week by SNCF railway workers, which left many commuters stranded on cold platforms. The complaint, said the unions, was “rampant privatisation”. This is baffling: the government reaffirmed this week that it plans no such thing. The railwaymen were staging what might be called a pre-emptive strike—a protest at the reorganisation of the SNCF, which faces competition for freight early next year, in case it leads to a sell-off. Many workers, already protected by generous pension provision, with retirement possible at 50 for train drivers, agreed to go back to work on the promise of yet another bonus and pay rise.

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Irish politics

A ghost that won't go away

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The spectre of Sinn Fein in the corridors of power proves hard to exorcise

THE next election may not take place for another 18 months, and the economy is doing well. So Ireland's ruling coalition ought to be quite confident. But something is keeping Dublin's politicians awake at night: the rise of Sinn Fein, the political wing of the Irish Republican Army. Bertie Ahern, the Taoiseach (prime minister), denies that he would ever contemplate a deal with the militant republicans. He even ruled out accepting parliamentary support from Sinn Fein, to form a minority government. He would rather take his Fianna Fail party into opposition than enter such a Faustian pact, he insisted.

Why did he feel obliged to protest so much? Partly because his rivals have used the whiff of suspicion that he might enter such a deal against him. And partly because the ruling coalition has failed to translate its economic achievements into popularity. Fianna Fail could find itself seeking support wherever it can—and a party like Sinn Fein, which hopes to increase its share of the vote to 10%, could be tempting. Already the junior partners in the coalition, the liberal-minded Progressive Democrats, have given warning that Sinn Fein may hold the balance of power after the next election. The main opposition party, Fine Gael, has been even blunter. Its leader, Enda Kenny, has told voters they face a stark choice between rule by Fianna Fail and Sinn Fein, mixing various shades of Irish nationalism, and a safer option of a coalition between itself and the Labour party.

Why—given that its IRA allies are supposed to have given up their arsenal and renounced violence—is Sinn Fein considered so untouchable? Mainly because of its wacky economic policies, and the sense that even a dash of Sinn Fein influence in high places would ruin Ireland's image as a nimble player of the globalisation game. Sinn Fein favours higher taxes all round: on income, on capital, on the banks and on the corporate sector. It is deeply hostile to the European Union—a view that finds little sympathy in the Irish establishment. In the words of Mr Ahern himself, Sinn Fein is an “agent of poverty and disadvantage”.

Gerry Adams, the Sinn Fein leader, is unlikely to be fazed by these words. In a hung parliament, his party might simply back Mr Ahern, even if there was no formal arrangement. Would Mr Ahern then resign, or would he stay in power? A lot of Irish voters would like to know.

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Economist.com WORLD EUROPE

Charlemagne

Barcelona dreams

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The European Union's awkward efforts to reform its southern neighbours

AMERICA can force countries to jump, but Europeans are better at inducing them to do it voluntarily. That is the European view. Their approach has worked brilliantly with the new and prospective members of the European Union, and had mixed results in the trickier parts of the Balkans. But, since September 2001, the Union's efforts to “spread stability” have faced an even harder challenge—how to influence the Muslim countries of North Africa and the Middle East, which have no prospect of ever joining the club.

Ten years ago, the EU launched a set of policies, dubbed the Barcelona process, that attempted to sweeten that neighbourhood through diplomatic patience, policy advice and some osmosis. This weekend, leaders from around the Mediterranean gather in the Spanish city to review how their efforts have gone so far, and to try to improve them. Much hangs on the outcome.

The EU sprinkles a total of almost €3 billion ($3.5 billion) a year, in grants and loans, from Morocco to Jordan, more than it gives to the former Soviet Union and almost as much as America ladles out to Egypt and Israel. Since American aid is largely military, the EU is now by far the most generous civilian donor in this turbulent area. The Barcelona process also provides the only regional forum in which Israel routinely sits down to talk to its Arab neighbours. It has become a meeting-place for protagonists in the supposed clash of civilisations, bringing together part of the West with a chunk of the Muslim world. It is also a rare-ish example of convincing, collective action by the Union—although France brings some national baggage to dealings with Algeria.

Above all, it is a test of a “third way” for western countries to deal with Muslim countries. Bombing them into democracy is not proving an easy triumph in Iraq. Leaving them to their own devices seems to be leading to government insanity in Iran. The European approach was ahead of its time, when it began, in 1995, to use economic incentives and the strengthening of civil society as tools to encourage reform. All countries bar Syria have signed tariff-cutting deals that are supposed to

lead to a free-trade zone with the EU by 2010. The process is intended to bring about significant economic integration with the EU for these Muslim countries, along with some involvement in their domestic regulation by Europeans. In other words, the Barcelona process is a prime example of the use of Europe's soft power, applied gradually.

And it has been a flop. At least, that is what many European diplomats think. The free-trade zone is unlikely to be up and running by 2010, although most tariffs should have been cut substantially by then. If the intention was to foster democracy, the Europeans have little to show for their money. Indeed, any elections that have been held in the region seem to owe more to American abruptness than to European patience. If the aim was to transform the economic and social affairs of the Muslim Middle East, the picture is mixed, at best. There has been little reform in the three biggest countries: Egypt, Algeria and Syria.

There are several explanations for this disappointing performance. The EU's policies have been too gradual in countries that feel immune to pressure, whether from below or from outside. Because Israel is a partner, Barcelona has often been hostage to the Palestinian peace process. The EU's efforts in the region range over areas such as transport, energy and agriculture, which, back in Brussels, are run by people who do not often consider thinking of the Muslim world to be part of their job description. If you add doubts about whether the EU can really afford its spending in the region, it is easy to see why internal problems stop it using its potential influence to the full.

But before concluding that the Barcelona process is a waste of time and money, it is worth asking if it has been quite the flop many people consider. The dispensing of economic advice is part of the process, so the EU can claim credit for helping to create (in every county bar Lebanon) macroeconomic stability. Most important, the EU's policy offered a stepping stone to three Mediterranean countries that are now members (Cyprus and Malta) or negotiating to join (Turkey).

A soft test-bed

The biggest test is whether EU soft power can work in places that do not have the powerful incentive of membership. Perhaps not in Egypt. But Morocco's reform of family law (which increases women's rights) was based partly on European advice. Recent economic reforms in Jordan and the Palestinian Authority stemmed from agreements with the EU. This does not mean that reforms would not have happened otherwise. But they might have been done differently, and possibly badly (helping countries in transition is one area where the EU has technical expertise, gained in central and eastern Europe). The record of the Barcelona process, in short, has been success in one group of countries (admittedly, the easy ones); failure in another (those with the least appetite for reform); and partial achievement in a third (those that wanted change anyway).

That is nothing to be ashamed of. But the impact of the EU's policies is likely to be still more uneven in future, partly because the policies themselves will probably change. The meeting in Barcelona this weekend is likely to offer more money to countries that meet more demanding political conditions. This will give the process some of the aggressive conditionality that it has so far lacked. Governments may also, usefully, consider extending their free-trade agreements to cover services and agriculture; and even start thinking about how best to talk about some sensitive military matters, such as weapons of mass destruction.

The lesson of the past ten years is not that soft power does not work when it comes to the Arab or Muslim world. It is that it will work only in some countries—and that there, among the coalitions of the willing, it needs to be speeded up.

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Politics

Good for me, good for my party

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Social enterprise, touted by Labour and the Conservatives as a big reforming idea, rests on some untested assumptions

CONVENTIONAL wisdom, according to economist J.K. Galbraith, is made up of “ideas which are esteemed at any time for their acceptability”. Social enterprise is fast becoming one of them. It has been talked about on the other side of the Atlantic for some time (Harvard Business School started a “Social Enterprise Initiative” back in 1993). Now its time to be esteemed in Britain seems to have come.

David Cameron, who as front-runner in the Conservative leadership race is determined to sound leaderly while keeping policy promises vague, is keen on it. “Just as business entrepreneurs have helped cure the British economic disease, so social entrepreneurs can help cure Britain's social malaise,” Mr Cameron reckons.

Support for the idea crosses the floor of the House of Commons. Labour's manifesto contains a promise to make sure that central and local government will work with social enterprises “wherever possible”. Social enterprise has its own lobby group, its own division within the Department for Trade and Industry (DTI) and, for the past year or so, a research and teaching unit at Oxford's Saïd Business School, funded by Jeff Skoll, one of the founders of eBay. But what is it?

No specific legal form fully captures the concept. Social enterprises sit on a sliding scale between those that are “social” because of the products they sell, to those that are social because of the people they employ or the way they are organised.

Cafédirect, a business created by Oxfam, a charity, sells only coffee for which growers have received a fair wage. It is now one of the biggest coffee brands in Britain. Farther along the scale is Fifteen, a restaurant started by Jamie Oliver, a television chef. It serves food prepared by young people who have known homelessness, unemployment, drugs and alcohol to Londoners pleased to pay £24 ($41) for a main course. Employees are encouraged eventually to down their pecorino graters and start up their own restaurants. Farther still is Daily Bread, a bakery business in Cambridgeshire with strong Christian values which employs staff who have a history of mental illness and other problems. It pays workers and bosses the same wage.

These businesses are often wholly or partly employee-owned. Most are also not-for-profit organisations and may have charitable status, which gives them tax advantages over normal businesses. There are 15,000 social enterprises in Britain, according to the DTI, which tried to count them recently. Someone familiar with the study described the methodology as “slightly alarming”, but no one has yet come up with a better estimate.

What really interests politicians, though, is how social enterprises can deliver services for the government. Charities already do some of this, particularly in the fields of mental or long-term illnesses. The line between charities and social enterprises is not always sharp. But the latter are

particularly attractive.

For the Conservatives, fostering social enterprises to fix the social problems that big cities specialise in is seen as a way back into areas where they have struggled to win support for a decade. For the Blairite bit of the Labour Party, social enterprises are attractive because they can bypass local bureaucracies and inject some drive into public service reform.

The government has accordingly set up an agency called Futurebuilders, which has a £215m fund to make loans to social enterprises that want to provide public services. So far the biggest loan has gone to the TreeHouse Trust, which runs a school for autistic children in London. But ambitions are far greater. Ministers have also been impressed by the voluntary sector's role in running job centres in Australia; they reckon this might be a way to get unemployed Britons off incapacity benefits.

There is ideology mixed in here too. For the Conservatives, social entrepreneurs sound like the small businessmen that the party likes to think it represents. They fit into the pleasing notion of a society made up of Edmund Burke's little platoons. Labour, for its part, can point to the mutual societies and co-operatives set up by reformers in the 19th and early-20th century as proof that social enterprise sits squarely in its own tradition.

Unprofitable leisure

The biggest growth in social enterprises recently has been in the field of leisure. A particularly successful example is Greenwich Leisure Limited (GLL), which set up as an “industrial and provident society” (like the working men's clubs founded in the 19th century) when the local council of the eponymous London suburb wanted to cut spending in 1993. The council saves money by paying GLL a fee to manage its leisure facilities. GLL has lower capital costs than its commercial competitors, and uses its surpluses to mix lower-income folk among its customers, drawing on what its managing director, Mark Sesnan, calls a “Robin Hood” pricing policy to do so. The management committee, elected by the employees, also ploughs earnings into expanding the business. GLL now runs over 50 leisure centres across London, and there are another 100 leisure trusts run on a similar model in Britain.

How widespread could these businesses become? “We don't think that there are any no-go areas, but things like oil refineries that are capital intensive are harder than things that are people-based,” says Jonathan Bland, chief executive of the Social Enterprise Coalition. But it is hard to see where all the entrepreneurs will come from. Spin-offs from public services are rare: people like Mr Sesnan, who worked for Greenwich council before setting up GLL, are exceptions. The parents who started the TreeHouse school did so only because the education that government was offering their children was so poor.

Even so, the idea is probably too useful to drop. For Labour, it provides a way to outsource public services without sounding like Conservative privatisers. For the Tories, social enterprise offers a way to improve public services without increasing the domain of the state. Whether they are political gimmicks or the New Jerusalem, social enterprises look as though they are here to stay.

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Ageing population

Must try harder

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Ranking Britain's oldsters at work

IN BRITAIN, as in other advanced countries, post-war baby-boomers are approaching retirement. A smaller generation will replace them in the workforce. As a result, the ratio of people aged 65 and over to the working-age population is set to soar, and with it financial pressure on fewer workers and taxpayers to provide for more pensions.

The dependency ratio will rise from 27% to 45% in Britain over the next 30 years—less than the increases in Italy or Germany, but still a leap to reckon with. Across rich countries, such rises are expected to push up state-pension spending as a share of the economy. Yet, remarkably, the government projects that the bill for pensions in Britain will stay broadly unchanged at around 5-6% of GDP.

It hopes to achieve this by concentrating spending on poorer retirees, notably through the means-tested pension credit which it introduced in 2003. But the policy has a fatal flaw. For it to work, employees on quite modest incomes will have to save more for their retirement. But the pension credit discourages them from doing this: it is withdrawn at a rate of at least 40% for every extra pound of savings income. Because state pensions are anything but lavish, almost two-thirds of all pensioners are expected to be eligible for the credit in 20 years' time. So this disincentive to save is affecting more and more workers.

On November 30th, the government-appointed Pensions Commission will map out an escape route from this policy dead-end. It will propose reducing the incidence of means-testing by making state pensions more generous, and would help pay for this by raising the state-pension. Gordon Brown, the chancellor, has already signalled that he is worried about the potential cost of the commission's proposal, leading to speculation that the government will bin it.

Yet raising the state-pension age will prove worthwhile only if it raises the effective-retirement age—the average age at which people leave the workforce. At present, the average British man soldiers on until he is 63. That is respectable by international standards (see chart) but much less impressive than the Japanese, Icelanders and Swiss, who work beyond the state-pension age. British women rank similarly to their menfolk, though their effective-retirement age of 61 is a bit higher than their state-pension age.

Over the past four years, the proportion of people of both sexes who work beyond the state-pension age has risen encouragingly. Yet, once again, some other countries do a lot better. In Britain, only a seventh of people aged 65-69 are still in the labour force, compared with between a quarter and a half in America, Japan and New Zealand.

This suggests that it is quite feasible for many more British people to carry on working in their late 60s, as the Pension Commission would have them do. But if the effective-retirement age is to rise, there will also have to be an end to early retirement. Over the past two decades, more people in their 50s have been leaving the workforce. Among those aged between 50 and the state-pension age in Britain, 30%—2.7m people—do not work; by contrast, only 20% of people aged 25-49 are not employed. And the comparison for men is even more telling.

This may look dismal yet it compares favourably with many other rich countries. The black mark against Britain is the degree to which people claim incapacity benefits. The proportion of men and women in their 50s who are out of the labour force because of illness or disability is among the highest in the OECD.

The government has postponed announcing its plans for shaking up incapacity benefits until early 2006. Its long-awaited proposals will be a litmus test of how serious it is about getting people to work longer.

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Drinking

Bar-room brawl

Nov 24th 2005 | MANCHESTER
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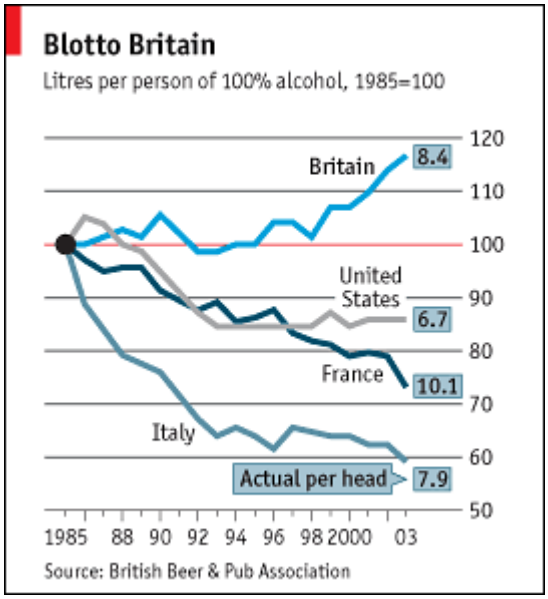
How a city fell in and out of love with drink



MANY British towns have a street or a neighbourhood packed with pubs, bars and nightclubs—a magnet for hedonists that the sober and the over-30 tend to avoid, especially on Friday and Saturday nights. Manchester has four such areas within a square mile. Such excess is appropriate in a city that, more than ten years ago, pioneered a boozy development strategy that has since been widely emulated. But Manchester's enthusiasm for drink now seems less like high spirits and more like a ruinous addiction.

Alcohol and its ill effects are now the salient “doorstep issues” in local politics, according to Marc Ramsbottom, a Liberal Democrat councillor. That is partly because of the 2003 Licensing Act, the most important parts of which came into force this week. The Act sweeps away fixed closing times, making it easier for drinking dens to stay open later. It is opposed by the Liberal Democrats and the Conservatives, by most newspapers and by 62% of the general public, according to a recent poll for the *Times*. In Manchester, though, the Act has merely sharpened opposition to the drink trade. Resentment runs deep.

The city council took the stopper out of the bottle in the mid-1990s. Gingerly at first, and then with gusto, it encouraged clubs and bars to open in deserted warehouses and shops. Such sites were plentiful: in common with other northern towns, Manchester's heart had been torn out by the departure of the textile industry. The hope was that alcohol would fuel a new, “24-hour” city, kick-starting the urban economy and luring residents and more sober business.

To begin with, the plan seemed to work well. “When I opened, this was a dark, dingy street with no lighting and buggered pavements,” says Andrew O'Dwyer, who owns a bar and nightclub in a now-buzzing area. Thanks to entrepreneurs like Mr O'Dwyer and the IRA, which in 1996 detonated a bomb in a particularly ugly corner of the city, Manchester began to smarten itself up. Retailers have flocked to the city centre: between 2002 and the end of next year, Manchester is expected to add a million square feet of retail space.

The problem is that the city is increasingly sodden with drink. Manchester's bars and clubs can accommodate more than 125,000 drinkers, and often pull in more than half that number. A combination of low prices, pushed down by stiff competition, and rising levels of disposable income has had the expected effect on drinking habits. The nation as a whole is imbibing more: the average Briton consumes 17% more than he did in 1995, even as Americans and many Continental Europeans have cut back on the bottle (see chart). Over-indulgence is compounded by

the way Britons like to drink: noisily, in large groups and in public.

Manchester's legions of drinkers are sometimes policed by as few as 50 officers. Such an imbalance is not unusual in a British city, though it is no less inadequate for that. Last year, some 836,000 English and Welsh adults were attacked by strangers, most of whom were drunk at the time, according to the British Crime Survey. That is a 7% increase on the 1997 level. Drunken punch-ups are more noticeable because many other kinds of criminality have declined. Overall crime has fallen by 35% in the past eight years.

But the 24-hour city's biggest problem is that it proved such a success. Sober folk flocked to it, just as the early 1990s boosters predicted. In 1991, only about 1,000 people lived in the centre of Manchester. Some 15,000 do so today, according to the city council. As a hedonistic playground came to be seen by an increasing number of Mancunians as a residential back yard, conflict became inevitable.

“We brought the area up, people moved in, and then they started to complain about the noise,” complains Mr O'Dwyer. “And the odd thing is, I have yet to see an advertisement for a city-centre flat that does not mention the vibrant night-life.”

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Temperance

Old wine, new bottle

Nov 24th 2005
From The Economist print edition

The dispute over alcohol licensing has overtones of 19th-century arguments

"THE impulse to excess among young Britons remains as powerful as ever, but the force that used to keep the impulse in check has all but disappeared," claimed a newspaper. Legislation that made it easier to get hold of a drink was "an Act for the increase of drunkenness and immorality", asserted a politician.

The first statement comes from 2005, the second from 1830. On both occasions, the object of scorn was a parliamentary bill that promised to sweep away "antiquated" licensing laws. As liberal regulations came into force this week, Britons on both sides of the debate unwittingly followed a 19th-century script.

Reformers then, as now, took a benign view of human nature. Make booze cheaper and more readily available, said the liberalisers, and drinkers would develop sensible, continental European-style ways. Nonsense, retorted the critics. Habits are hard to change; if Britons can drink easily, they will drink more.

Worryingly for modern advocates of liberalisation, earlier doomsayers turned out to be right. Between 1820 and 1840, consumption of malt (which is used to make beer) increased by more than 50%. Worse, Britons developed a keener taste for what Thomas Carlyle called "liquid madness"—gin and other spirits.

The backlash was fierce. Critics pointed to widespread debauchery in the more disreputable sections of the working class. They were particularly worried about the people who, in a later age, came to be known as "ladettes". An acute fear, says Virginia Berridge, who studies temperance at the London School of Hygiene and Tropical Medicine, was that women would pass on their sinful ways to their children.

In the 19th century, temperance organisations set up their own newspapers to educate the public about the consequences of excess. That, at least, has changed: these days, the mainstream media rail against the demon drink all by themselves.

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Economist.com WORLD EUROPE

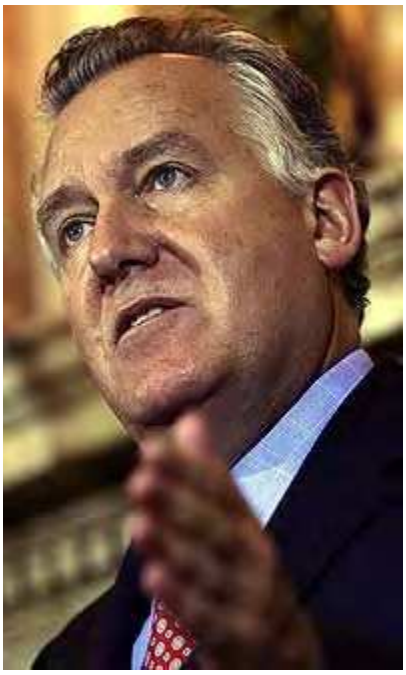
Northern Ireland

And now, get on with it

Nov 24th 2005 | BELFAST
From The Economist print edition

The tizz over Peter Hain's proposals on local government and terrorists

PA



Get article background

IT DOESN'T take much to rile Northern Ireland's politicians, and Peter Hain, Britain's secretary of state for the place, provided plenty of fuel this week. The proposals he unveiled on November 22nd for reducing the six counties' bloated public administration were denounced by all the parties except Sinn Fein, the IRA's political arm. A day later, a government bill to allow terrorists on the run to come out of hiding without going to jail provoked such outrage on its second reading in the House of Commons that it will probably have to be amended to get through the Lords. Yet neither was a surprise.

The review of public administration has been in the works since before power-sharing by nationalists and unionists in the Stormont assembly was suspended three years ago. When the IRA laid down its arms in September, the way was cleared to help Northern Ireland find its political and economic feet at last. And slicker administration is obviously needed.

While bullets and bombs pre-empted politics, Westminster allowed a sprawling, multi-layered bureaucracy to spring up in the region. The idea was to maintain reliable “bins and burials”—order amidst chaos—and to provide at least minor platforms for aspiring local politicians.

Five education and library boards, a separate body for Catholic schools, four health and social services boards and 18 health trusts today serve 1.7m people in a place where no two points are more than 100 miles apart. As a result, three out of ten workers are employed in the public sector (compared with two in ten in Britain as a whole). Public spending per head is 30% higher in Northern Ireland than in Britain, and the annual subsidy from Westminster is some £2 billion.

The new administrative scheme crunches the 26 existing and relatively powerless councils into seven super-councils. Health and education will be run by single authorities for each council. The seven are also to have responsibility for planning, economic development, local roads and more. Local councillors will see their numbers cut by almost two-fifths. Mr Hain claims that the measures could save up to £200m a year, as well as produce better services for all.

Letting fugitive paramilitaries re-emerge—to be given a criminal record and put “on licence” but escape imprisonment—has also been under discussion for a while. Those who were convicted of offences and jailed before the Good Friday Agreement was signed in 1998 have already been freed. Those who were sought but not convicted before that date present an “anomaly” which

must be dealt with in order to re-build effective government, Tony Blair told senior MPs this week. Nevertheless, by exempting those terrorists from any sort of public accounting, the bill has awakened both personal anguish and broad political opposition. The government fought off a bid in the Commons to block the bill entirely, but will have to make concessions if it is to be enacted.

Behind the two proposals is a growing impatience in Westminster over the time it is taking to bed down Northern Ireland's newly declared peace and restore some version of power-sharing. The moderate nationalist Social Democratic and Labour Party is worried by the growing dominance of its more extreme rival, Sinn Fein, as attention is focused on taming the IRA. Ian Paisley's Democratic Unionist Party, meanwhile, still abhors the notion of breaking political bread with Sinn Fein.

By pulling together lots of little units into big blocs, the administrative reforms will reveal with uncomfortable starkness the fault lines in the region: three super-councils in the west will be controlled by Catholic nationalists, three in the east by Protestant unionists, and the two sides will continue to slug it out in Belfast. And debate on the bill to allow back terrorists, however integral it may be to the peace process, seems bound to exacerbate divisions in the short run.

The government's plans were always likely to attract criticism. Mr Hain made that probability a certainty last week with some provocative remarks during a visit to America. He wants Northern Ireland's economy to be much more self-sufficient, he said in a newspaper interview, not “the dependent economy it is now, with a sort of UK big brother umbrella over it”. It will be “increasingly difficult to look at the economy of north and south except as a sort of island of Ireland economy”.

The phrase “island of Ireland” in the mouth of a British minister sends shivers down the spines of Protestants in Ulster who are permanently uncertain of Britain's commitment to the union. Mr Hain also said that it was past time for Sinn Fein to show its dedication to peace by agreeing to support policing in Northern Ireland. They should “cut the crap and get on with it”, he told readers of New York's *Irish Echo*. Roughly phrased, but right.

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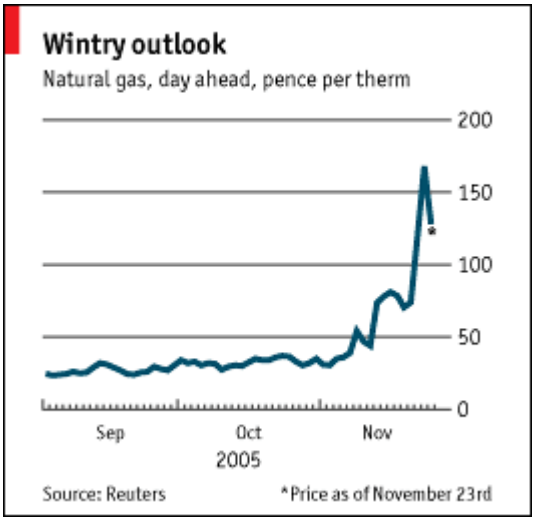
Natural gas

Chilling

Nov 24th 2005
From The Economist print edition

Winter worries mean gas prices have gone haywire



ENERGY is fast becoming one of the biggest issues in British politics. Ambitious promises to develop renewable sources and the government's apparent determination (hinted at again on November 22nd) to build a new fleet of nuclear power plants have kept the subject in the public eye. Another simmering controversy erupted as natural gas prices—which had been rising for months, along with the oil price—shot to record levels this week (see chart). Falling again as *The Economist* went to press, they were still far above their levels of just two weeks ago.

The sudden price hikes infuriated business users of gas, especially big industrial firms. Many have switched over the past year from annual, fixed-price contracts to spot-price ones, and some have had to cut back production as prices rose. Business groups gave dire warnings that expensive gas would lead to factory closures this winter and called on the government to rethink its energy policy. Malcolm Wicks, the minister responsible, was unimpressed: he said the price spike was “irrational” and pointed out that, in any case, there was little the government could do.

Several factors lie behind the volatility in gas prices. The immediate reason is that weathermen are predicting a colder-than-average winter, the first for many years. The market has been jittery for months. Frigid temperatures could severely strain the system, with big industrial users cut off in order to keep households warm. A recent cold snap seems to have spooked gas buyers, many of whom are now reckoning on future shortages. And sharp price spikes often generate their own momentum.

A broader explanation is the slow decline of the North Sea, and Britain's change from being a net exporter of energy to a net importer. That will require plenty of investment in new infrastructure to bring gas in from outside. Ministers and industry bosses have planned for this, approving an upgrade to the big Zeebrugge-Bacton pipeline that links Britain to the continent, and the construction of new lines from Norway and Holland. A new terminal designed to take shipments of gas in frozen form opened in Kent in July, and two more are due to open by the end of 2007. But until the new facilities are up and running, gas supplies will be tight.

And Britons are discovering that more capacity does not necessarily mean more gas. The Kent terminal has been quiet ever since it opened. Shipments have been diverted to take advantage of high prices in other countries such as Spain and the United States. Pipeline imports from Europe are running far short of what they could be. David Cox, the boss of ILEX, a consultancy, thinks that the French and Germans are wary of releasing stored gas on to the market so early in what

could be a long, cold winter.

Britain's lack of storage capacity has amplified the market's fluctuations. Historically, the North Sea's bounty made stockpiling gas unnecessary. If demand rose, more gas could be pulled out of the sea to meet it. Falling production, and a shift away from natural gas fields to combined oil and gas deposits, means that this approach is no longer possible. Gas reserves can meet only 4% of annual demand, compared with around 20% in Germany, France and Italy.

Many commentators see price spikes in times of shortage as the flip-side of the same liberalised energy markets that provide cheap gas in times of plenty. Philip Wright, a professor at the University of Sheffield, points out that liberalised markets thrive on information that was hidden in the old, vertically-integrated monopolies. Even small shocks to supply can be amplified as other firms rush to take advantage of the information.

Nevertheless, the Conservatives—the architects of the original market liberalisation—jumped at the opportunity to stick it to the government. So far, ministers have stuck to the line that gas is a privately run business and that government interference is the last thing industry needs (although they have grumbled about the glacial pace of liberalisation in the European markets on which Britain will increasingly rely). Mr Wicks says that only the heaviest industrial users would be affected by an extremely cold winter, if one does occur. That's true, but only if the freeze is short-lived. Because gas generates around 40% of Britain's electricity, a prolonged chill would affect domestic energy prices as well. That would annoy voters, whose bills have already risen sharply over the past months. The last thing the government wants now is a white Christmas.

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Dancing schools

All the world's a stage

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How the government pampers talented children

The stuff of dreams—and subsidies

IF YOU have a small daughter, chances are you'll have come across Angelina Ballerina. A pink-tutu-clad mouse with “lots of determination, tremendous natural ability and enormous passion”, she is just one of the reasons why so many little girls are mad about ballet (the pink satin shoes are another). But only a few will stay keen into adolescence. Some will grow more interested in contemporary or jazz dance, perhaps aspiring to work in musicals or pop videos. Most give up dancing lessons altogether.

To have any chance of becoming professional dancers, the few who stay the course must start intensive training young, preferably by the time they are 11. It is possible to take GCSE and A-level dance at some state schools, but the syllabus isn't rigorous enough to provide all the training needed. Dedicated dancers will probably have to go to privately run evening classes, or even full-time independent specialist schools.

In the educational jargon, a child who is good at dancing or art or sport is “talented”; one who is good at maths or science, say, is “gifted”. Although this may seem mere semantics, it has a practical consequence: the government considers it unacceptable for schools to select the most gifted applicants, but not the most talented ones. Not all would agree that the government pampers talented athletes, for example: this is a constant complaint when the Olympics roll around. But the way it funds budding dancers is exceptional.

Four different government schemes pay for dance students from age 11 to receive the best training at about 20 private schools and colleges. Not even lip-service is paid to mixed-ability teaching. Admissions are highly selective and funding is awarded solely on ability, with parental income taken into account only when setting the exact level of support. The biggest of the four schemes creates a sort of mixed economy, paying for the most talented 60% who are offered places at participating schools. The rest are left to find their own fees of around £10,000 ($17,000) a year.

It's hard to see why “talented” students should be treated so differently from “gifted” ones. Not even the most committed ideologue can believe that every child has what it takes to be a dancer, it seems, though why nuclear physics is considered within reach is elusive.

Perhaps there is a different reason. Those who make a career in dance face poor prospects, a short working life and low pay. Performers work professionally for an average of only 11 weeks a year, according to the Council for Dance Education and Training. Darcey Bussell, a 36-year-old principal dancer with the Royal Ballet and a star of the first water, announced last month that she

would be retiring in the summer of 2006. She said that the cost of child care for her two daughters was only just covered by what she earned. That never seemed to be a problem for Angelina Ballerina.

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Bagehot

Now comes the hard part

Nov 24th 2005
From The Economist print edition

David Cameron must convince voters he is changing the Tory party. He has surprisingly little time

SINCE his spectacular emergence at the Tory conference, David Cameron's progress towards victory has appeared effortless and inevitable. It probably doesn't feel like that to him. First he had to translate his Blackpool momentum into hard votes at Westminster. Then he had to prove he could stand up to the street-fighting skills of David Davis in televised hustings, hounding by the media pack over whether he took drugs at Oxford and an inquisition by the BBC's Jeremy Paxman at his sneering, pantomime-dame worst.

By projecting smooth affability, sticking blandly to his lines about the need for the party to change itself in various unspecified ways and declining to get into a bidding war with Mr Davis about who could come up with the daftest policies, he has come through more or less unscathed.

His only big mistake, made when his campaign was in the doldrums, was to promise to pull Tory members of the European Parliament out of the centre-right, but federalist-inclined, European People's Party (EPP) grouping. It was a blatant sop to the Europhobe head-bangers who deserve much of the blame for what has gone wrong for the Tories over the past 15 years.

Not surprisingly, Mr Cameron has at times seemed a little bored and desperate for the whole protracted business to be finished with. Well, now it very nearly is. Barring some catastrophe, on December 6th Mr Cameron will be duly crowned. If the polls of party members prove as accurate as they have in the past, he should beat Mr Davis by at least two votes to one. At which point, the

hard part begins.

This is not just because Mr Cameron will suddenly find himself pitched into gladiatorial combat with Tony Blair on the floor of the House of Commons. Testing though his first few sessions of prime minister's questions will be, they are unlikely to be defining. But Mr Cameron and his team know that his first 100 days as leader are a critically important period that may determine whether he becomes the next-but-one prime minister or fizzles into irrelevance like his three predecessors.

Their logic is that the people Mr Cameron must reach and persuade that the Conservative Party has altered enough to win their support—the 10% or so of swing voters who decide the outcome of elections—are by their nature not very interested in politics. That means that there may be only two chances to catch them when they are paying attention: in the countdown to a general election and immediately after Mr Cameron becomes leader. The next few months, when people will still have an open mind about him, are vital.

Nobody should underestimate how difficult the task will be. Because media coverage of the leadership contest has been extensive, the Tories think they have become interesting again. But for all the interviews with the candidates, the highly publicised television debates and Mr Cameron's own attractions, the party's poll ratings have not budged from 33%.

If Mr Cameron is to make an impact he knows he must move quickly to prove that he really is changing the party. What's more, he is going to have to do it without much in the way of policy. He is insistent that every existing policy will have to be thoroughly re-thought; superficially exciting ideas must be developed to withstand rigorous testing. The reaction to George Osborne's sudden enthusiasm for flat taxes was a warning against half-baked notions. The shadow chancellor—and manager of Mr Cameron's leadership campaign—is right to argue against excessive complexity in the tax system, but he made himself look silly by returning from a brief trip to Estonia proclaiming he had seen the future.

What does that leave? The first thing Mr Cameron must do is pick a shadow cabinet. If, as seems likely, he persuades William Hague to return to frontline politics, probably as shadow foreign secretary (Mr Osborne wants to stay put), he will have added talent to his team. More importantly, Mr Hague, who would be taking a large pay cut to do so, will in effect be demonstrating that he believes the Tories have elected a winner. If Mr Davis, a likely source of dissent, is sidelined into shadowing defence (a difficult job for a Tory to turn down), Mr Cameron will have added ruthlessness to his other attributes.

He will need it if he is to succeed in his second task: shifting the Tories' entire approach to opposition. If Mr Cameron is serious about abandoning the unprincipled opportunism that has stripped his party of intellectual respectability, there is no better moment for him to begin than by supporting the main recommendation of the the government-appointed Pensions Commission, which reports next week, that the retirement age should be raised to 67. He has also indicated that he is likely to back Mr Blair's legislation early next year giving schools more autonomy and further eroding monopoly provision in the health service. That will be hard for many of his colleagues to swallow, but it would be a dramatic signal of change.

Not just Mr Nice Guy

If Mr Cameron means what he says, he is also going to have to be bold in changing the way the party selects its parliamentary candidates. While nearly 28% of Labour MPs are women, the Tories can muster fewer than 9%. There are more than twice as many Davids in the shadow cabinet as there are women. All-women shortlists, the method used by Labour to increase female representation, might be going too far, but even if Mr Cameron were to opt for 50/50 shortlists in

the 100 most winnable target seats he would have a fight on his hands.

And that's the thing. If Mr Cameron really wants to prove he is changing the Tories, he will have to upset quite a lot of people. Mr Cameron has come this far by being nice. To go any further, he is going have to know when to be nasty as well.

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Addio, Dolce Vita

Nov 24th 2005
From The Economist print edition

Alamy

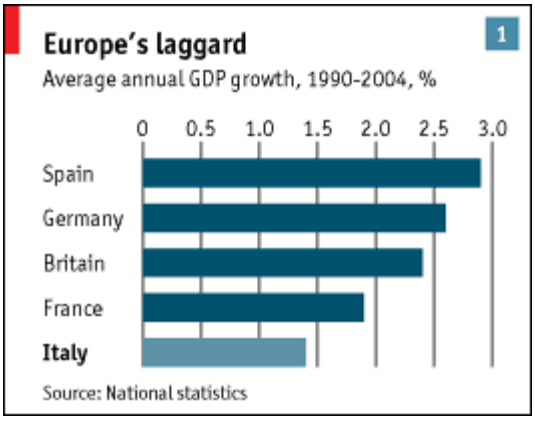
For all its attractions, Italy is caught in a long, slow decline. Reversing it will take more courage than its present political leaders seem able to muster, says John Peet (interviewed here)

AT FIRST blush, life in Italy still seems sweet enough. The countryside is stunning, the historic cities beautiful, the cultural treasures amazing, and the food and wine more wonderful than ever. By most standards, Italians are wealthy, they live for a long time and their families stick impressively together. The boorish drunkenness that makes town centres in many other countries unpleasant is mercifully rare in Italy. The traffic may be bad, and places such as Venice and Florence are overrun by tourists, but if you go off-season—or merely off the beaten track—you can have a more enjoyable time in Italy than practically anywhere else.

Yet beneath this sweet surface, many things seem to have turned sour. The economic miracle after the second world war, culminating in the famous 1987 *sorpasso* (when Italy officially announced that its GDP had overtaken Britain's), is well and truly over. Italy's average economic growth over the past 15 years has been the slowest in the European Union, lagging behind even France's and Germany's (see chart 1). Its economy is now only about 80% the size of Britain's. Earlier this year Italy briefly tipped into recession; for 2005 as a whole, its economy is likely to be the only one in the EU to shrink. Growth next year is expected to be anaemic at best.

Italian companies, especially the small, family-owned firms that have been the backbone of the economy, are under ever-increasing pressure. Costs have risen, but productivity has remained flat or even declined. Membership of the euro, Europe's single currency, now rules out devaluation, which for many years acted as a

safety-valve for Italian business. Italy's competitiveness is deteriorating fast, and its shares of world exports and foreign direct investment are very low. The World Economic Forum in its annual competitiveness league table recently ranked the country a humiliating 47th, just above Botswana. The economy has also proved highly vulnerable to Asian competition, because so many small Italian firms specialise in such areas as textiles, shoes, furniture and white goods, which are taking the brunt of China's export assault.



Down at heel

The effects of decline are starting to show. Increasing numbers of Italians are finding their living standards stagnating or even falling. The cost of living is widely believed to have risen sharply since euro notes and coins replaced lire in January 2002. Property prices have certainly shot out of reach for many first-time buyers in Rome, Milan and even Naples. Many Italians are cutting back on their annual holidays, or even going without. Others are putting off buying new cars or even new suits, a real deprivation for such design-conscious people. Supermarkets report that spending now falls in the fourth week of every month before the next pay cheque arrives, a sure sign that families are struggling to make ends meet.

A lacklustre economy is causing broader problems too. Italy's infrastructure is creaking: roads, railways and airports are falling below the standards of the rest of Europe, and public and private buildings are looking ever shabbier. Educational standards have slipped: the country comes out badly in the OECD's PISA cross-national comparisons, and no Italian university now makes it into the world's top 90. Spending on research and development is low by international standards.

Italy has also suffered more than its fair share of corporate scandals, notably the bond default by Cirio and the collapse of Parmalat. And the public finances are in a shambles. Respectable estimates put the underlying budget deficit for next year, ignoring one-off measures, at 5% of GDP, way above the 3% ceiling set by the euro area's stability and growth pact. The public debt stands at over 120% of GDP and is no longer falling.

Even Italy's social fabric is coming under strain. The family remains strong and divorce rates are relatively low. But the fact that 40% of Italians aged 30-34 are reportedly living with their parents is not just a happy sign of family harmony or attachment to mamma's cooking. Many young Italians stay at home because they cannot find work or because they do not earn enough to afford a place of their own.

Social trust, a concept that is admittedly hard to measure, seems unusually low in Italy—one reason, perhaps, why family firms have always played such a big part in the economy. And respect for the rules, and even the law, never high, appears to have fallen further in recent years. Both tax evasion and illegal building, encouraged by repeated amnesties, seem to be on the rise. Organised crime and corruption remain entrenched, especially in the south.

To cap it all, Italy's demographics look terrible. The country has one of the lowest birth rates in western Europe, at an average of 1.3 children per woman, and the population is now shrinking; yet Italians are living ever longer, so it is also ageing rapidly. The economic consequences—too many pensioners, not enough workers to maintain them—are worrying enough on their own. What makes them worse is Italians' low rate of participation in work. Only 57% of those in the 15-64 age range are in employment, the smallest proportion in western Europe. Germany, by

comparison, has an employment rate of 66%, and Britain one of 73%. Although overall unemployment in Italy is not too bad by west European standards, it is disturbingly high among the young and in the south.

Berlusconi's legacy

What has gone wrong with the Italian economy, and how can it be put right? These are the main questions this survey will seek to answer. But it will do so in the context of Italy's unruly political scene. Silvio Berlusconi's centre-right government, elected in May 2001, seems likely to manage the rare feat of staying in office for a full term (ending next spring)—a first for a post-war government in Italy. Mr Berlusconi is immensely proud of this. But he has much less to be proud of when it comes to the economy. In his 2001 election campaign, he promised to apply the business acumen that had helped him to become Italy's richest man to make all Italians richer. This he has conspicuously failed to do.

The Economist's view of Mr Berlusconi is well known. We declared in April 2001 that he was unfit to lead Italy, because of the morass of legal cases brought against him at various stages of his business career and because of the conflicts of interest inherent in his ownership of Italy's three main private television channels. Almost five years on, he still faces legal problems (of which more later), and he has done little to resolve his conflicts of interest: indeed, because the government owns RAI, the state broadcaster, Mr Berlusconi now controls or influences some 90% of Italian terrestrial television (which does not stop him complaining about his critics on TV). Our verdict of April 2001 stands.

Yet, as we acknowledged at the time, in 2001 there was nevertheless a case to be made for electing Mr Berlusconi's centre-right coalition. Italy badly needed a dose of pro-market reforms, liberalisation, privatisation, deregulation and a shake-up of the public administration, all of which Mr Berlusconi had promised. He even pledged to cut taxes. A majority of Italian voters, backed by much of Italian business, were willing to overlook both his legal entanglements and his conflicts of interest and give him a chance to reform the country. But as the next election approaches, very little of what he promised has been delivered, so many of his erstwhile supporters are feeling disillusioned.

Even the apparent political stability that Mr Berlusconi has fostered is deceptive. His six-party centre-right coalition has come close to collapse more than once, usually thanks to squabbling between Umberto Bossi's Northern League and Gianfranco Fini's National Alliance. Last April a row with a smaller ally, the Union of Centre and Christian Democrats, forced Mr Berlusconi to resign and form a new government.

On current form the centre-left opposition under Romano Prodi looks the likeliest victor in the election planned for April 9th 2006. But even if he manages to win, Mr Prodi will find it hard to introduce reforms—not least because his coalition embraces no fewer than nine parties, several of which will obstruct change. It was an ally of Mr Prodi's, Fausto Bertinotti, and his unreconstructed Communists that pushed him out of office in 1998. In truth, neither of the two main groupings in Italian politics offers much hope to those who believe that the country needs radical (and painful) reform.

Yet Italy is approaching a crunch. Rather like Venice in the 18th century, it has coasted for too long on the back of its past success. Again like Venice, it has lost many of the economic advantages which underpinned that success. For Venice, it was a near-monopoly on trade with the East that paid for the creation of its beautiful palaces and churches; today's Italy has benefited hugely from a combination of low-cost labour and a switch of workers away from low-productivity farming (and the south) into manufacturing (mostly in the north). But such good things invariably

come to an end.

That is what happened to *La Serenissima* at the end of the 18th century. Venice was contemptuously swept away by Napoleon, and the last doge voted himself out of office. The serene republic is now little more than a tourist attraction, however beguiling. Could this become the fate of Italy as a whole?

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The search for scapegoats

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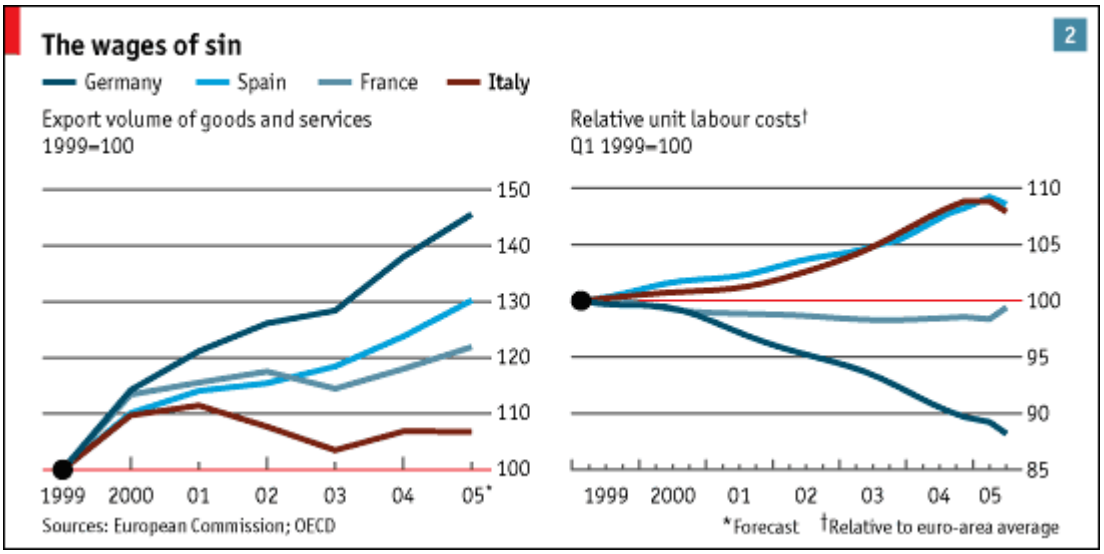
Economic troubles are always someone else's fault

SOME of the ills that have made Italy the new “sick man of Europe” may be beyond its control. The present government certainly likes to suggest that they are. Ministers point out that the whole of the EU, and especially the euro zone, has also been struggling economically, especially since the terrorist attacks on America of September 11th 2001. Italy's finance minister at the time, Giulio Tremonti, was quick to blame the terrorists for Italy's sluggish economy.

When he returned to his old job two months ago, after the sudden resignation of Domenico Siniscalco, Mr Tremonti soon found two new scapegoats at which to point an accusing finger: the euro and China. The political subtext was none too subtle. It was the opposition leader, Romano Prodi, who as prime minister in 1998 took Italy into Europe's single currency; and who as a former president of the European Commission could be charged with favouring globalisation and opening up the European market to Chinese imports.

Certainly the macroeconomic background of the past few years has been unhelpful to Italy. A near-stagnant, ageing Italian population has done little for domestic demand. Fiscal policy has of necessity been constrained: the previous government had to cut the budget deficit sharply in order to qualify for the euro, and the present one has had its hands tied by the EU's stability and growth pact. In its early years the European Central Bank's monetary policy has, arguably, been too restrictive for countries such as Italy and Germany, reflecting the difficulty of setting a single interest rate to suit 12 hugely diverse economies.

But Italy's biggest weakness over the past few years has been its export performance (see chart 2). The country's largest market is Germany, whose domestic economy, and hence appetite for imports, has recently been far from hale and hearty, although its exports are booming. Italy suffers from the opposite problem: its domestic consumption is holding up reasonably well, but its competitiveness has been sliding, which has led to a fall in its share of world exports.



This is where the euro comes in, albeit not in quite the way that Mr Tremonti and some of his colleagues like to argue. Many Italians sincerely believe that the changeover from the lira to the euro triggered a burst of inflation that cut living standards and eroded competitiveness. These problems, they feel, were exacerbated because the euro rose against the dollar. Persuaded by this argument, some in the Northern League, notably Roberto Maroni, the welfare minister, are now saying that the lira should be brought back. Mr Maroni has even tried to collect enough signatures for a referendum on the matter. Mario Monti, a former European commissioner and now president of Bocconi University in Milan, points out that the Northern League has performed a complete about-turn. In the mid-1990s it was so enthusiastic about the single currency that it wanted the north ("Padania") to join alone if the country as a whole found itself unable to meet the conditions.

In reality the euro has not been nearly as bad for Italy as the critics suggest. Inflation, which came down sharply ahead of Italy's entry into the fixed-exchange-rate regime in 1999, has remained low; indeed, this has been one of the key benefits of euro membership. The switch to euro notes and coins three years later had a negligible effect on the general price level, according to Italy's generally reliable statistical office. Admittedly the price of a few everyday goods and services rose steeply as some tradesmen exploited the confusion at the time of the switch-over. Restaurants and bars were certainly guilty of cashing in: hence the often-heard complaint that the price of a cup of coffee doubled overnight. The government should have done more to stop such profiteering. But this sleight-of-hand does not support the argument, which even senior politicians like to trot out, that many Italian businesses chose to convert all their prices at 1,000 lire to €1, not the correct rate of 1,936 lire to €1.

A different model

What is undeniable is that the euro has perforce broken Italy's habit of frequent devaluation. In effect, membership of the single currency has forced Italy to change its entire economic model. Instead of relying on high inflation, high budget deficits and currency devaluations, it has had to learn to live with low inflation, low budget deficits and a fixed single European currency. It is not surprising that such a massive adjustment has been painful, and so far remains incomplete—notably because wage and price inflation are still higher than in other euro-zone countries.

Does that mean that Italy should have made a different choice? Mr Maroni and his allies like to point to Britain to show that a country can thrive inside the EU but outside the euro. Yet the comparison is misleading. Britain has not followed a path of high inflation, a high budget deficit

and frequent devaluation outside the euro, and nor would it have been possible for Italy to do so. The sharp devaluations of the lira in 1992, and again in 1995-96, brought furious responses in other European countries, especially France. Had Italy persisted with its previous practice, it is hard to see how the single European market could have survived.

Don't cry for me, Italia

More dramatically, Italy might have come a cropper too. For there is another, more unnerving example of a country that has preferred to go its own way: Argentina. The worrying parallel is not that Argentina is a country with a strong Italian heritage, or that it was once rich but has become relatively poorer, but rather that it adopted an extreme variant of the old Italian model: high inflation, high public spending, high budget deficits and frequent devaluations. All this came to a halt in 1991, when Argentina adopted its “convertibility” plan to fix the peso against the dollar, the equivalent of Italy's decision to join the euro in 1998. Yet in Argentina, inflation, high public spending and budget deficits persisted. The result was a loss of competitiveness and a wrenching recession—and, in January 2002, the sudden demise of the convertibility plan as Argentina simultaneously devalued and defaulted (which, incidentally, proved costly for Italian savers, many of whom were heavily invested in Argentinian debt).

It makes a grim story, and there are plenty of gloomy analysts who predict a similar fate for Italy. Yet the analogy with Argentina might have been closer still had Italy retained the lira, and thus been subject to the same sort of speculative pressure that eventually broke Argentina's link to the dollar. For example, an Italy outside the euro would not have escaped relatively unscathed from the recent resignation of Mr Siniscalco and the associated controversy over the governor of the Bank of Italy (see article).

Indeed, it is membership of the euro that has made Italy's public-debt burden bearable by cutting its servicing costs sharply. Mr Siniscalco declares that, when he was finance minister, he thanked God every day for the euro, without which his job would have been even more impossible than it was already. Most Italian businesses also strongly support Italy's continuing euro membership.

This implies, however, that to remain competitive without recourse to devaluation, Italy must introduce structural reforms to boost productivity and hold down costs, as well as sorting out its public finances. The euro has, in effect, exposed Italy's true weaknesses, which are microeconomic in nature. They include rigidities in product and labour markets and insufficient competition. These structural problems are to some extent shared by all countries in the euro zone, but in Italy they often seem worse. They will be discussed in more detail in the next article.

If nothing is done, might Italy end up on the same track as Argentina, forcing it to leave the euro, devalue and perhaps default? In a country that is a member of the rich G7 club, such an event would be cataclysmic, which may be why financial markets do not seem to expect it. The spread of Italian debt over German debt remains relatively small. But it has widened in the past year or so, and credit-rating agencies have begun to sound the alarm over Italy's government debt, the third-biggest in the world. Italy remains highly unlikely to leave the euro, voluntarily or otherwise. Even so, the country should pay heed to the warnings it is starting to get from the markets.

Paradoxically, although euro membership has made it more urgent for Italy to deal with its structural faults, it may also have made it easier to avoid doing so, by cutting interest rates and eliminating exchange-rate crises. As the OECD puts it in its most recent report on Italy: “It is somewhat ironic that EMU membership...may, in effect, have relaxed the perceived need for structural adjustments on both the supply and fiscal sides.”

Something similar happened in Argentina after it adopted its convertibility plan: people started to

believe that biting the bullet of a permanently fixed exchange rate was enough, on its own, to cure the economy's problems. In both countries, the new fixed-exchange-rate regime came to be seen as the end point of the reforms, rather than a prelude to broader structural adjustments. The need for these in Italy is now greater than ever.

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Structurally unsound

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So easy to pinpoint what is wrong, so hard to put it right

Corbis

Last of the line

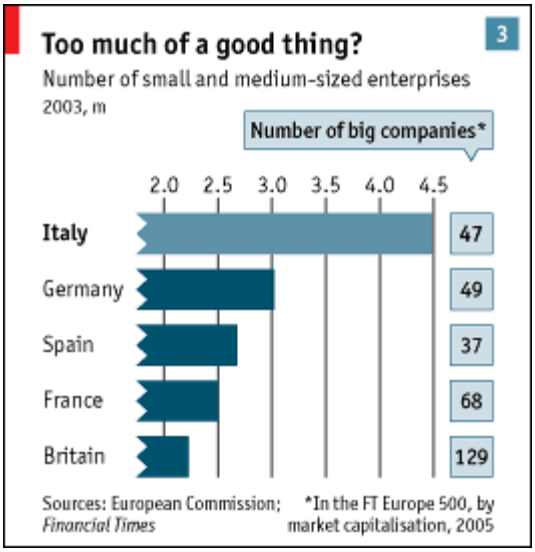
OVER the past decade or two, the structural failings of the Italian economy have become brutally clear. What makes them especially hard to deal with is that for years many of them were seen not as weaknesses but as strengths. Asked to explain what is wrong with Italy, Francesca Bettio, an economist at Siena University, has an instant answer: the family. It is responsible for the fact that most Italian companies are small and privately owned; it has contributed to a low female participation rate in the workforce; and it is at least partly to blame for low social and labour mobility.

Yet for many years after the second world war, the family was considered an asset, not a liability, in Italian business. This can be seen most clearly in the proliferation of (often family-owned) small firms across northern Italy, many of them grouped in clusters: woollen goods in Biella, cotton textiles in Varese, shoes in Ascoli Piceno, knitwear in Carpi, women's clothing around Treviso (home of Benetton, among others), and so on. At one time these clusters figured in business-school studies as a key source of Italy's economic strength, especially in the north, now one of Europe's richest regions.

Indeed, Italy as a whole became a case study in “small is beautiful”. About two-thirds of manufacturing workers are in firms with fewer than 100 employees, compared with 37% in America and 31% in Germany. Italy has more small and medium-sized enterprises than any other country in Europe: some 4.5m, or roughly one-quarter of the total in the EU 15 (see chart 3).

The flip-side of having lots of small firms, however, is a dearth of big ones. For a member of the G7, Italy has remarkably few big companies: for many years the list barely ran beyond Fiat, which at one time accounted for almost 5% of Italy's GDP. One reason for this is the

heavy weight of the state, which used to own most of the big banks, utilities and even many industrial firms. IRI, the giant state holding company originally created by Mussolini, was once run by none other than Romano Prodi. Even today, many of the big companies in Italy are formerly state-owned utilities and banks. Over the past two decades, while Italy's nifty small firms were garnering so much praise, the country has lost much of its presence in industries such as chemicals, pharmaceuticals, computers and food processing.



When bigger is better

What is wrong with having lots of small firms? There are two answers. One is that globalisation and competition from Asia (especially China) have put a bigger premium on size. In the 1960s and 1970s it was enough to supply the home market, or at most reach out to such near neighbours as France and Germany, and to rely on your local bank for finance. Now to be successful a company such as Benetton has had to grow to the point where it supplies a world market and obtains its products far beyond Italy; it is quoted not only on Milan's stockmarket but New York's too.

Italy's stockmarket is tiny in relation to the size of the economy, with fewer than 300 quoted companies. The market's chief executive, Massimo Capuano, has plenty of ambition to lure more, not least through a special second market for smaller enterprises. But many owners of such firms resist any loss of control and even dislike relying on external finance. Restoring public confidence in a market that was hit hard in December 2003 when Parmalat, one of Italy's biggest food groups, went bust is also proving challenging. Parmalat had claimed to have large cash balances that turned out to be fictitious. Government legislation to improve corporate governance in the wake of the scandal is currently becalmed in parliament.

The other problem with Italy's small firms is that too many of them are in the wrong industries, relying for too long on cheap labour for their competitive advantage. The textile firms in the north that have spent much of the past year bleating for protection are classic examples. They had ten years' warning of the demise of the World Trade Organisation Agreement on Textiles and Clothing that limited imports from developing countries. Yet when the agreement expired at the start of this year, many firms rushed to Brussels to demand “voluntary” restraints on Chinese exports. Others joined the chorus attacking Italy's membership of the euro. Very few seemed willing to accept any blame for failing to establish new niches based on good design, marketing or the use of technology, rather than cheap labour.

Yet there are many examples of successful Italian firms, even small ones, that have made just such adjustments. Fifteen years ago Benetton produced almost 90% of its clothing in Italy; now the share is down to less than 30%. Geox, an innovative and successful shoemaker, produces most of its goods abroad, as does Luxottica, the world's leading maker of sunglasses. In white goods, Merloni (now Indesit), which was set up 30 years ago, has become Europe's third-biggest supplier of fridges, cookers and washing machines. Its founder, Vittorio Merloni, who is still chairman, notes that almost half the company's products are made abroad, including in China, which he first visited back in 1975. China is also, he complains, a source of counterfeit goods, complete with the “Made in Italy” label and even the washing-machine guarantee.

Another successful example is Cerutti, a maker of sophisticated printing presses based in Casale Monferrato, near Turin. Its chief executive, Giancarlo Cerutti, remembers that when his father

founded the firm after the second world war, it had seven rivals. Now there is just one other maker of big printing presses, and Cerutti has almost 60% of the world market. It supplies many of the newspapers and magazines in Europe, as well as several in America. Recently it bought a production facility in China. It also has a technical centre in India, employing some of the country's finest engineers.

Italy's flagship computer firm, Olivetti, went under in the mid-1990s, but there are some Italian success stories in information technology too—and not only in the north. Near Catania, in Sicily, ST Microelectronics, a chipmaker, is part of a vibrant high-tech cluster. ST was founded in the 1960s, but was on the verge of bankruptcy when Pasquale Pistorio, now its honorary chairman, rescued it in the early 1980s. Mr Pistorio not only turned the company round, but expanded it by opening production plants near Naples and in Bari. He has nothing but praise for the skill and high quality of Italian engineering graduates.

Yet Mr Pistorio also concedes that Italy has plenty of problems. He notes that high-tech exports make up only 12% of the total, half the European average. Italy spends only 1.1% of its GDP on research and development, compared with the EU average of almost 2% and as much as 3.2% in Japan. Bureaucracy and the judicial system are slow, liberalisation is incomplete, infrastructure is poor, and the tax “wedge” that pushes up labour costs is one of the largest in Europe. Mr Pistorio reckons that the Berlusconi government has failed to create the right conditions to attract investment, whether from domestic sources or from abroad, and has not done enough to encourage innovation.

The theme is taken up vigorously by Luca Cordero di Montezemolo, chairman of both Fiat and Confindustria, the Italian business lobby. Mr Montezemolo knows all about business turnarounds: he rescued Ferrari and has helped to pull Fiat Auto back from the brink. Yet Fiat's recovery owes much to financial, not mechanical engineering. It has extracted cash from GM to allow the American car firm to drop an option it unwisely took out to buy the whole company, and it has insisted that its banks convert some of their loans into equity. Whether it has a long-term future will depend on its new models, notably the new Fiat Punto.

Sitting in his office above the glitzy Ferrari production line in Maranello, south of Modena, Mr Montezemolo says that Italy will pay a high price if it fails to introduce structural reforms. Top of his list is more competition, which among other things will involve more privatisation. His other priorities for reform are educational change, including in the universities; infrastructure, throughout the country; public administration, including the tortuously slow judicial system, which he sees as a big deterrent to foreign investors; and, echoing Mr Pistorio, more innovation and investment in R&D.

Mr Montezemolo makes it clear that Italian business is deeply disappointed with Silvio Berlusconi's centre-right government, which had promised so much when it took office in 2001. At the time Mr Berlusconi told Confindustria that “your programme is my programme”, but he has not delivered. However, Mr Montezemolo does not confine his criticism to Mr Berlusconi: he attacks all the politicians who have run the country in the past two decades for failing to take tough decisions. Nor does he accept that reform-minded governments always lose elections, citing counter-examples such as Britain.

It would be wrong to say that the Berlusconi government has done nothing in the way of reform. In two areas, pensions and the labour market, it has been quite bold, although it has built on changes set in train by previous governments. Given its demographic outlook, Italy still needs to do more to reduce its formidable pensions burden; and the government has timidly put off the start of some of its more painful reforms until 2008. But by raising the retirement age, cutting pension values and encouraging private pension funds, it has done more than some other EU countries to tackle this looming problem.

Reforms in the labour market have been even more striking. The Biagi law, named after Marco Biagi, a labour-market adviser who was assassinated for his pains, exempted many new jobs from rules that required most work to be full-time and permanent. This has led to a boom in temporary and part-time posts. The privatisation of labour exchanges and changes to apprenticeship contracts will inject even more flexibility into the Italian labour market, promises Maurizio Sacconi, the minister responsible.

Mr Sacconi claims that, in the past five years, Italy has created a net 1.2m new jobs, 700,000 of them for women, a better record than any other country in Europe (including Britain). Yet although unemployment for Italy as a whole, now just under 8%, is relatively low by European standards, Mr Sacconi acknowledges that it remains high among the young (almost 23%), the old and in the south.

Moreover, Italy's strong employment record has a downside: zero or even negative productivity growth (see chart 4), as more marginal and less productive workers have been brought into the workforce. It is the combination of poor productivity growth and rising wages that has caused Italy's unit labour costs to rise so much faster than those in other euro members in the seven years since the euro started.

So much to do

Mr Siniscalco, who quit as finance minister in late September, praises the government's pension and labour-market reforms, but acknowledges that too little has been done to increase competition, to liberalise protected parts of the economy or to privatise (indeed, the centre-left government before Mr Berlusconi's sold more assets than he did). As for the EU's “Lisbon agenda” of economic reform, Italy has consistently come out bottom in the scorecards of the London-based Centre for European Reform—although that may change now that a liberal-minded Europe minister, Giorgio La Malfa, is in charge of Italy's Lisbon strategy.

The obstacles to greater competition in Italy are legion. The OECD reckons that Italy suffers from the heaviest product-market regulation in Europe. Energy markets need a lot more liberalisation to match the most open in Europe; Italian energy prices are correspondingly high. The government remains the largest single shareholder in ENI, the big oil company, and Enel, the main electricity firm. It still has a golden share in Telecom Italia, although it has at least pushed through the sale of its remaining shareholding in the company. Antitrust enforcement in general is patchy.

Murky corporate governance in Italy has also been a deterrent to investment, and perhaps even to the creation of successful companies. For years even quite big firms were controlled by small groups of shareholders, often through a cascade of different holding companies. Mediobanca, a secretive Milan-based investment bank, pulled many strings from afar. Minority shareholders were mostly ignored. More recently, Italy's stuttering economy has exposed a series of corporate scandals that have weakened investor confidence.

Finance, a crucial area for an economy's competitiveness, is another big Italian weakness. The banks have changed a lot over the past 15 years: an industry that was mostly state-owned and highly fragmented is now 90% private, and the Bank of Italy has fostered a spate of domestic mergers. A few banks have emerged as kingpins: Banca Intesa; Unicredit, which this year took over Germany's HVB; Sanpaolo IMI; and Capitalia. Yet the Bank of Italy has tried to keep out foreign investors, which may help to explain why bank charges (and profits) are among the highest in Europe. The governor of the Bank of Italy, Antonio Fazio, did himself and his institution no good by trying to prevent a takeover of an Italian by a foreign bank earlier this year (see article).

Banking is not alone in benefiting from protection by its own regulator. There is not enough competition in services in general, which matters because the share of services in the Italian economy, as elsewhere, is going up—they now account for two-thirds of GDP. Small shops, taxi firms, pharmacies, notaries, tradesmen: in the land that invented guilds in the Middle Ages, most are still protected from competition by special rules, often administered by local authorities. As an example, Vito Tanzi, formerly Italy's director at the IMF in Washington, DC, tells the tale of a man who wanted to open a fish shop in a small town in Apulia but was turned down by the council on the ground that the town had one already.

Tourism is another area that would benefit from both more investment and more competition. For a country that has so much to offer in the way of culture, nature, climate and cooking, Italy's tourist industry is surprisingly undeveloped—and hotel and restaurant prices seem unduly high. In 1970 Italy was the world's top tourist destination. Today it comes fifth, after France, Spain, America and China.

One general problem is that the whole notion of service is rather undervalued. Indeed, Italy often seems to suffer from a pervasive anti-business, anti-customer culture. Italians may be entrepreneurial and creative, but they are by no means pro-market. Neither of the two main post-war political parties, the Christian Democrats and the Communists, could be described as economically liberal. Nor is the Catholic Church, still a huge influence in the country, which has always affected to disdain profit. In any case, many businessmen in Italy do better by exploiting contacts and seeking favours from the state than by building up companies or trying to serve customers better. A prime example is Mr Berlusconi, whose business success was based largely on the help and protection of certain Italian politicians.

This cultural preference for favour-seeking and the creation of protected monopolies over free-market competition could take a long time to shift. It is, naturally, also reflected in Italian politics. Why have Italian politicians, on both sides, been so slow to embrace reforms, and what are the prospects for change?

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Fazio's folly

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From The Economist print edition

A central banker too independent for comfort

Reuters

Secure in his job

IT USED to be an article of faith among Italy-watchers that, however incompetent the country's other institutions might be, at least the Bank of Italy could be relied upon. In the 1990s it even supplied two prime ministers, Carlo Azeglio Ciampi (now the country's president) and Lamberto Dini. But the central bank's credibility has been shot to pieces by the intransigent behaviour of its governor since 1993, Antonio Fazio.

Mr Fazio has long opposed foreign takeovers of Italian banks. Even so, earlier this year, a Spanish bank, BBVA, and a Dutch one, ABN Amro, made bids for two Italian banks. Mr Fazio promoted rival domestic bids for their targets, leading the European Commission to ask whether Italy was discriminating against other EU countries. Central banks in other European countries may have their own ways of discouraging foreign bidders, but none is as explicit about it as Mr Fazio.

As it happens, Mr Fazio has pursued some perfectly sensible policies, promoting privatisation and mergers among Italian banks. Yet his response to the bid by ABN Amro for Banca Antonveneta was outlandish. He overruled his advisers by endorsing a rival bid by Banca Popolare Italiana, a shaky institution run by a close friend, Gianpiero Fiorani. Wiretaps leaked by prosecutors recorded Mr Fazio phoning Mr Fiorani after midnight to say he had just approved the bid. But when it became clear just how rocky BPI's finances were, its bid fell apart and ABN Amro won the day.

For Mr Fazio, the story is by no means over. His intervention was attacked from all sides. His friends were quick to detect an anti-Catholic, masonic or even Jewish conspiracy against him (Mr Fazio is an ardent Catholic who goes to mass every day). Exasperated members of the government, including the finance minister, Domenico Siniscalco, called for his resignation. When Mr Siniscalco failed to win the cabinet's backing, he quit (although not solely over the Fazio affair: problems with the 2006 budget also played a part). Following Mr Siniscalco's departure, even the prime minister, Silvio Berlusconi, called for Mr Fazio to go, and suggested that the European Central Bank might boot him out.

The trouble is that, in the mid-1990s, the Italian government, in its eagerness to join the euro, made its central bank more independent than any other in Europe. Mr Fazio's appointment is for life. He thinks he has done nothing wrong and is reluctant to sacrifice his job as the best-paid central banker in Europe. He can be removed only by the board of directors of the Bank of Italy, which is technically a private institution—and he chose most of the board members himself.

The government has drafted a new law to renationalise the Bank and make its governor subject to a term limit, but it is languishing in parliament. A defiant Mr Fazio has shown that he has friends in high places, not only in the Vatican but in the Northern League, the National Alliance and even

in some opposition parties. The odds are that, whatever the pressures on him, he will stay until the next election—and he might not quit even then. After all, at 69, he is two weeks younger than Mr Berlusconi. Why should he give up any sooner than *Il Cavaliere*?

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You can't win

Nov 24th 2005
From The Economist print edition

Why Italian politics is impossible

Reuters

Berlusconi hangs on

MANY countries have complex political systems that reflect their past more than their present. But Italy's politics is unusually hard to fathom—just as its governments have been unusually fragile. In fact, considering the umpteen governments and prime ministers the country has got through, the system was for many years surprisingly stable.

Until the 1990s, Italian politics was dominated by two parties: the Christian Democrats and the Communists. Because by common consent during the cold war the Communists were kept out of government, every administration from 1946 to the early 1980s was led by a Christian Democrat. There followed a decade of coalitions, all of which included the Christian Democrats, but some of which were led by a Republican, Giovanni Spadolini, and others by a Socialist, Bettino Craxi.

This stable system was blown apart by three events that reverberate still. The first was the collapse of Soviet communism in the late 1980s, which led to a split in the Italian Communist Party. The second, starting in Milan in early 1992, was a series of bribery cases known as *tangentopoli* (bribesville), led by a group of magistrates who became known as *mani pulite* (clean hands). These cases led to the conviction and flight of Mr Craxi, as well as to the demise of most of the old parties. The third event grew out of the second: the decision by Silvio Berlusconi, a media magnate, to enter politics and found a new party, Forza Italia (roughly, “Go, Italy!”).

Thanks in part to his money and his media empire, and in part to Italians' disillusionment with the old system, Mr Berlusconi enjoyed instant success. His centre-right grouping won the election in 1994, only a few months after the establishment of Forza Italia. But his government lasted only eight months before being brought down by one of his allies, Umberto Bossi's Northern League.

The first Berlusconi government was followed by a technocrat-led one. The next three governments were headed by centre-left prime ministers, the first of whom, Romano Prodi, led his “Olive Tree” coalition to victory over Mr Berlusconi's “House of Liberties” in the 1996 election. Mr Prodi brought in painful budget cuts and a special tax to ensure that Italy got into the euro, but the coalition then suffered a fit of internal squabbling. Mr Prodi was ousted and, in May 2001, Mr Berlusconi's House of Liberties coalition won a convincing majority over the Olive Tree coalition in both houses of parliament.

Go, Berlusconi!

This was the moment that Italian business had been waiting for. Here, at last, was a coalition of the right with sufficient political clout to bring in long-overdue reforms. Yet, as we have seen, they

were destined to be disappointed. The House of Liberties coalition has implemented reform only in limited areas, and the economy's poor performance and the country's loss of competitiveness have continued unchecked. Budget deficits have been kept down mainly by one-off measures. And for the past 18 months or so, the centre-right has been trounced every time Italians have been allowed near a ballot box, starting with the European elections in June 2004 and culminating in the rout at the regional elections last April, when the centre-left won every region being contested except Lombardy and Veneto.

This dismal performance has four explanations. The first is that, right from the start, the Berlusconi government was distracted by the time and energy it devoted to measures to deal with the prime minister's own interests and to fend off judicial cases against him (see article). These included laws to downgrade the offence of false accounting, to make it harder to use evidence from abroad, to provide for cases to be moved to a different court if there is any suspicion of judicial bias, and to shorten the statute of limitations after which offences are automatically expunged. To top it all, in mid-2003 a new law was passed to give the prime minister, as well as four of his associates, blanket immunity from prosecution while in office. This law was, deservedly, struck down by Italy's constitutional court.

The second reason that reform has proved difficult is the state of the economy. As other European countries have found, it is much harder to deregulate product markets or promote more competition when there is little or no growth. Low growth also confounds the budget arithmetic and leaves no scope for higher spending or tax cuts to cushion the short-term impact of changes. The catch-22 is, of course, that reforms become essential precisely when the economy has run out of steam. The Berlusconi government is not alone in Europe in failing to resolve this conundrum.

A third factor is, however, more peculiar to Italy. The country has moved towards a bipolar system of two broad groups, the centre-right and the centre-left, in part thanks to an electoral reform in the 1990s which provided for some 75% of the seats in parliament to be elected on a first-past-the-post basis. This was meant to discourage splinter parties, yet the influence of smaller parties remains disproportionately strong. It may even increase if, as seems likely, the government succeeds in changing the electoral law to move back to full proportional representation. The opposition has cried foul over this reform, which seems tailor-made to disadvantage the centre-left. As things stand, it will also introduce a complicated system of thresholds for representation in parliament the effect of which on smaller parties is not yet clear. But most parties seem resigned to the new system.

Reuters

Prodi waits for the call

The big problem, as Mr Siniscalco knows from bitter experience, it that pushing through potentially unpopular reforms is extremely hard when every party within a coalition has a veto. Although Forza Italia is the biggest party on the centre-right, Mr Berlusconi has had to keep on board the National Alliance, the Northern League and the Union of Centre and Christian Democrats. Each of these has its own constituency to protect, and none is a natural supporter of free markets.

The fourth point is perhaps the most important: that Mr Berlusconi himself is not a true believer in free markets either. His own business success was built on the creation of near-monopolies that, far from being attacked by antitrust authorities, benefited from political friendships. The most notorious example is his Mediaset television empire, which needed the strong support of a Socialist leader, Mr Craxi. But even his early business career depended on favours, such as diverting the flightpath out of Linate airport to boost the value of his properties near Milan. Mr Berlusconi's instincts are those of a trader in favours and privileges, not of a competitor in unfettered markets. That is a useful qualification for a politician, but less so for building a

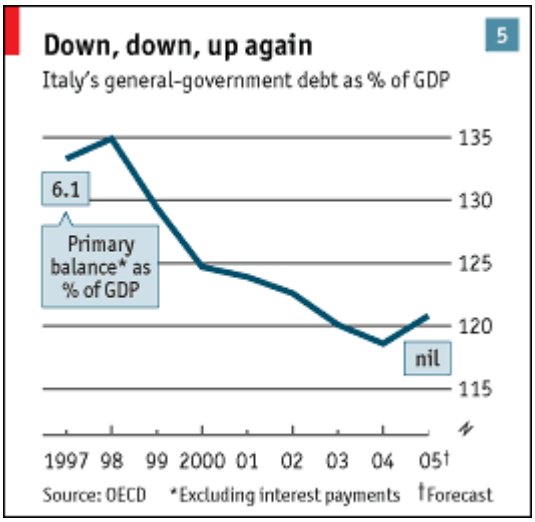
successful liberal economy.

Despite all this, the Berlusconi government has done some things right, and not only in labour-market and pension reform. The education minister, Letizia Moratti, has worked hard to promote research and to improve Italian universities, though there is still a long way to go. As one Italian university professor disarmingly puts it, “the nice thing about this job is that you don't have to do any work.” Pay and promotion are largely determined by seniority, and Italy has proportionately fewer foreign academics than most other countries. Recent street protests in many cities led by university professors denouncing Mrs Moratti must be a sign that she is doing something right.

America's friend, and Russia's

On the whole, the government's foreign policy must be counted a success too. Mr Berlusconi braved the wrath of many of his EU allies and his own public opinion by sending troops to join America and Britain in Iraq, though he is now trying to argue that he had misgivings about the war and sought to talk George Bush out of it. His government has generally been more assertive about Italy's role in the world than its predecessors. Within the EU, it has been less deferential towards France and Germany. If Mr Prodi returns to office, he is likely to switch the emphasis back towards backing the Franco-German duo.

Mr Berlusconi's government has been more staunchly pro-American (and pro-Israel) than most previous ones. The one blot in foreign policy has been Mr Berlusconi's partiality for Russia's Vladimir Putin, whom he appears to see as another businessman-turned-politician under unfair attack from the media. During Italy's six-monthly presidency of the EU in 2003, Mr Berlusconi caused consternation in Brussels by refusing to criticise Mr Putin at an EU-Russia summit meeting in Rome. He also lost international credibility for his chairing of the EU summit in Brussels in December 2003 that failed to agree on the text of a draft EU constitution.



On defence, although like many other European countries Italy still spends too little, it has in the past few years made a useful contribution in places such as Kosovo and Afghanistan as well as in Iraq. The defence minister, Antonio Martino, is also seeing through a plan to abolish conscription and to overhaul the arms-procurement system. If Mr Prodi returns to office, there is a serious risk that his government might choose to pull troops out of Iraq too quickly, as Spain's then new prime minister, José Luis Rodríguez Zapatero, did after March 2004.

Mr Martino is one of Italy's few avowed liberals, but his influence on economic policy has, sadly, been small. Still, the government has at least brought in some tax cuts. Its stewardship of the public finances, however, has been dreadful. It inherited a useful primary budget surplus (ie, before interest payments) of as much as 5% of GDP, but it has frittered that away to zero (see chart 5). Moreover, although Mr Tremonti's repeated tax amnesties have seemed to keep annual budget deficits within bounds, the price of this may have been to increase Italy's already high level of tax evasion. Opposition politicians claim that tax evasion now adds up to as much as *euro*200 billion ($234 billion) a year. This bears heavily on those in paid employment, who find they have to pay higher taxes than they otherwise would.

Nor has the government made much of a dent in public spending. It is not hard to come up with

ideas for cuts, just as it is not hard to find things to privatise. Giovanni Tamburi, an investment consultant based in Milan, has produced a detailed list of possible asset sales, including of foundations that still own some banks, as well as a programme of liberalisation. Such measures would, on his estimates, yield as much as *euro*200 billion a year. Some of these assets are, admittedly, in the hands of local authorities, but it remains striking how reluctant Mr Berlusconi has been to sell anything. Patronage, it seems, retains its allure.

Another undesirable legacy of the Berlusconi government is a devaluation of civic and public ethics. When a prime minister attacks his country's magistrates as part of a left-wing conspiracy, passes laws that benefit his own interests and issues repeated amnesties for people who have evaded taxes and ignored planning controls, he sends a message to the average citizen: do not bother to obey the rules. The judicial system badly needs modernising to speed up the processing of cases and reduce queues, and his government has introduced reforms which it claims will do this, but no one else seems to agree.

Would the opposition be a big improvement? It would undoubtedly encourage people to be more law-abiding, although even Mr Prodi has had minor brushes with scandal. Yet there is something dispiriting about the fact that Italian voters next April are likely to face the same choice as they did ten years earlier, between two candidates in their late 60s. Mr Prodi says many of the right things about introducing more competition and liberalisation, but you would hardly call him a liberal or a reformer. Moreover, like Mr Berlusconi, he will be hostage to other parties in his own coalition. He notes that, unlike in 1996, the Communists under Fausto Bertinotti are now formally part of the centre-left coalition, as opposed to backing it from outside, and denies that he is some sort of Mr “Prodinotti”. But he knows that he will not find it easy to keep all the small left-leaning parties behind him.

Reuters

Fini looks to the right

He has made several efforts to increase his chances. The first was to suggest that the parties of the left should campaign on a single platform. This was shot down by one of his closest supporters, Francesco Rutelli of the Democracy and Freedom Party. However, the idea may now be revived, partly thanks to Mr Prodi's second plan: to hold a primary of all Italian voters to endorse the centre-left's candidate for the election. This was duly put into effect, and last month Mr Prodi overwhelmingly won the ballot, on a surprisingly high turnout. That has left him rather better placed not merely to face Mr Berlusconi but perhaps also to keep a grip on his own coalition if it wins.

What next?

Mr Berlusconi now seems sure to be the candidate facing Mr Prodi. Earlier this year he flirted with the idea of stepping down to make way for somebody more popular to lead his alliance, most likely Pier Ferdinando Casini, the speaker of the Chamber of Deputies. But he changed his mind, and after a few hiccups and with a few reservations, his coalition partners now seem to endorse his candidacy.

What would happen to the centre-right if Mr Berlusconi loses the election? Presumably he would quit, and few would then expect Forza Italia to survive in its present form. There are no obvious successors to lead the centre-right. Mr Casini is a possibility, but a more plausible candidate for the leadership might be the present foreign minister and leader of the National Alliance, Gianfranco Fini.

Mr Fini is certainly a man to watch. When he first joined Mr Berlusconi's government in 1994, he was only just emerging from the neo-fascist MSI party, which formed the basis of the National Alliance. He once declared that Mussolini had been the greatest statesman of the 20th century. But for the past ten years he has been increasingly distancing himself from this past, denouncing Mussolini, cultivating Israel and serving as a briskly efficient foreign minister. Along the way he has shed some of his harder-line supporters, including the *Duce*'s grand-daughter, Alessandra, and cemented his position as the most popular leader of the centre-right.

The only political leader who is even more popular than Mr Fini is Walter Veltroni, an ex-Communist who served as culture minister under Mr Prodi in the 1990s and is now a successful mayor of Rome. When Mr Berlusconi and Mr Prodi eventually retire, Mr Fini and Mr Veltroni may be well set to take over as the next generation of political leaders.

One thing that Italy lacks is a truly liberal-minded party. The closest are Giorgio La Malfa's Republican Party, a tiny group that has thrown in its lot with the centre-right; and the Radical Party of Marco Pannella and Emma Bonino, which is not now represented in parliament. Mario Monti, at Bocconi University, caused a stir recently by questioning the ability of either coalition to implement reforms. Many saw this as a call for a new centre party, but Mr Monti seems to have no serious plans for one. More's the pity: Italy badly needs more believers in the free market.

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The strange cases of Silvio Berlusconi

Nov 24th 2005
From The Economist print edition

A prime minister with nine legal lives

Get article background

SILVIO BERLUSCONI proudly points out that, for all the legal cases brought against him over the years, he has never been convicted. He seems to see this as evidence that the magistrates involved must be biased, part of a left-wing or even a Communist conspiracy. Yet the picture is not quite as simple as he maintains.

Over the past few years, *The Economist* has studied the charge sheet against Mr Berlusconi extensively. We published our findings in the issues of April 26th 2001 and July 31st 2003. (On the second date, much of the detail was published on Economist.com only.)

The table summarises Mr Berlusconi's legal travails. Two points stand out. The first is that, even though he has not been definitively convicted in all of these cases, Mr Berlusconi has not been definitively cleared, either. In several cases he was initially found guilty but then acquitted simply because the statute of limitations had kicked in.

The charge sheet

Case	Business	Charge	Verdicts (after appeals*)
Villa Macherio	Property	Tax fraud; false accounting	Acquitted on three counts, statute of limitations† on one
Medusa	Films	False accounting	Acquitted
AC Milan player	Football	False accounting	Statute of limitations†
All Iberian	Offshore company	Illegal financing of political party	Statute of limitations†
Mediolanum, Mondadori, Videotime, Telepiu	Finance, publishing, films, TV	Corruption; bribery of financial police	Acquitted
Mondadori	Publishing	Corruption; bribing a judge	Statute of limitations†
Fininvest 1&2	Holding company	False accounting	Statute of limitations†
SME	Food	Corruption; bribery of judge	Acquitted on three counts, statute of limitations† on one
Mediaset	Television, films	Tax evasion; misappropriation of funds	Preliminary hearing

Source: *The Economist* *If applicable †Under the Italian penal code, the statute of limitations extinguishes the crime

The second point is that his election victory in 2001 enabled his government to change the law in various ways that have made it easier for him to escape further convictions. The most notable example was the offence of false accounting, which was downgraded and had its statute of limitations shortened early in the present parliament.

Even so, two of Mr Berlusconi's closest friends have fallen foul of the law. Marcello Dell'Utri, a Forza Italia senator from Sicily who once ran Publitalia, the advertising wing of Mr Berlusconi's Mediaset empire, was convicted in 2004 by a court in Palermo of aiding and abetting the Mafia (he is appealing against the verdict). Prosecutors in Palermo do not suspect either him or Mr

Berlusconi of being, or having been, *mafiosi*. But they know that the Mafia strongly supported the establishment of Forza Italia, and that it may have found Mr Dell'Utri a useful channel. In the 2001 election, the centre-right captured every one of the 61 first-past-the-post seats in Sicily.

The second friend in trouble is Cesare Previti, formerly Mr Berlusconi's personal lawyer and defence minister in his 1994 government. Mr Previti was convicted in a judge-bribing case, but Mr Berlusconi himself escaped under the statute of limitations. Mr Previti is appealing, but the government has been trying to rescue him with a new law, known as the “Salva Previti” bill, to shorten the statute of limitations. The bill might not now save Mr Previti, but it could help Mr Berlusconi in his latest case, on charges of tax evasion and misappropriation of funds. If it is passed, it will bring further discredit to Italian public life.

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Southern cross

Nov 24th 2005
From The Economist print edition

What can be done to make it more bearable

IT IS easy to think of European countries that have trouble with their regions. There is Spain, with Basque and Catalan aspirations for independence; Germany, with feistily autonomous Bavaria and a depressed east; perhaps France, with Corsica and other little pockets of independent-mindedness. But Italy seldom figures on the list, and indeed it does not suffer from serious or violent separatism—even the Northern League's talk of a breakaway "Padania" is really just a way of pressing for more regional devolution, not independence. Yet Italy has a regional problem that is in some ways more serious than all the rest: its south, or *mezzogiorno*, with its chronically troubled economy.

Italy's regions have been given significant extra powers and substantial budgets (notably for health care) over the past decade, largely in response to the Northern League's demands. Cities have elected mayors, some of whom—such as Walter Veltroni in Rome—are figures on the national stage. The government recently brought in a set of constitutional changes, now passed by both houses of parliament, to give regions even more powers over education and social services.

This is said to be the biggest change to Italy's constitution in 50 years. But the centre-left opposition is against it, and the measure needs approval in a referendum, probably after the next election. Moreover, it fails to settle what is always the trickiest issue in any devolution of power: money. The regions and provinces do control some taxes, but one of the most important of these is IRAP, a form of local value-added tax on business that is of questionable legality under the EU treaties and is due to be abolished. For the time being, a big part of the regions' money will continue to come from central-government grants. This is a recipe for duplication, waste and unaccountable spending, and it may make Italy's already messy public finances harder to control.

Even so, if designed sensibly, more federalism would be a good thing in a disparate country that was united less than 150 years ago. Piedmont and the Veneto feel utterly different from Apulia or Sicily. Federalism also pleases the Northern League and its supporters. But it will not do much for the *mezzogiorno*. The two big problems of the Italian south are a poorly performing economy, too dependent on the public sector; and pervasive corruption and organised crime. These cannot be solved merely by giving the regions greater autonomy. In many ways, Italy, once many countries, is now two: the affluent 37m who live in the north, and the much poorer 20m who inhabit the south.

In search of a cure

Over the years, many cures have been prescribed for the southern economy. The first was migration: a disproportionate share of Italian emigrants in the late 19th and early 20th centuries came from the south. Large numbers of southerners also went north to work in new car plants and factories. But although emigration can produce a flow of remittances, it removes some of the brightest and most energetic workers and does nothing to create a dynamic economy at home.

In any case, the south now faces an entirely different migration problem: the huge numbers of illegal immigrants trying to enter the country from northern Africa across the Mediterranean. Many of them come in leaky boats, hoping to land on the islands of Lampedusa or Pantelleria. Italy is less used to handling immigration, whether legal or illegal, than most other EU countries; for many years it allowed people to enter fairly freely in the expectation that most would merely pass through on their way to their final destination, Germany or elsewhere in northern Europe. But as a member of the borderless Schengen group, Italy has now been forced to tighten its controls, especially in the south. Ironically, this comes at a time when the country's population is shrinking and it should—like the rest of Europe—be looking for more, not fewer immigrants.

The second attempt at curing the south's economic troubles came in the form of investment in factories, often state-owned. These included giant steel and chemical works, the Alfa Sud car plant, shipbuilding and others. These plants became known as “cathedrals in the desert”. They suffered from chronic low productivity, low-quality output and relatively high costs, as well as growing competition from other countries. Most of them have been closed down over the past three decades.

The third prescription was to encourage small firms to set up in or move to the south to replicate their success in the north. The region around Naples, especially around Mount Vesuvius, is littered

with small textile companies, many of which resemble the sweatshops of Asia. Farther south, Basilicata has lots of small furniture-makers. But the entire *mezzogiorno* is suffering from low-cost Chinese competition. And this is not a region famous for its strong entrepreneurial spirit or its flexible labour market. A big reason why unemployment is so high is that wages tend to be set nationally, when they really ought to be much lower in the south. In a region with little respect for the law, the underground economy is also large.

It is not all hopeless, however. Gianfranco Micciché, the Italian government's minister for the *mezzogiorno*, points to successive OECD and IMF reports which have acknowledged that public administration in the south is improving. He also claims that the unemployment gap with the north is shrinking: in 2001, he says, unemployment in the south was 21%, but it has since come down to only 14%. Over the same period, he adds, the rate of take-up of available EU regional funds has risen from a paltry 40% to almost 100%. The eastern regions seem to be doing better than the western ones. The biggest problems are now concentrated in Campania, Calabria and Sicily.

The south is not without its successful industries and cities. The mayor of Naples, Rosa Russo Jervolino, agrees that the city has suffered from a loss of basic industries over the past decade, but points to aerospace and high technology as areas of growth. The universities in Naples have a high reputation for engineering. She concedes that Naples's image needs “revitalisation”, but the recovery that was set in train in 1994 by her predecessor, Antonio Bassolino, has continued. The city's infrastructure is improving, and the local economy has recovered from the near-demise of its biggest bank, Banco di Napoli, which is now part of San Paolo IMI.

Robert Aberman

Good at laundering

Two centuries ago Naples was one of the biggest cities in Europe and capital of a prosperous kingdom (hence the venerable, note-issuing Banco di Napoli). Its setting below Vesuvius is spectacular, its archaeological museum world-beating, and the San Carlo opera house claims to be Europe's oldest. Naples ought easily to outdo such other Mediterranean cities as Barcelona in tourism and as an investment location. Yet Barcelona, boosted by the 1992 Olympics, has left Naples in the dust. Mr Bassolino, now regional president of Campania, made much of his city's hosting of the G7 summit in 1994, but the legacy has endured less well. Naples may have escaped from the deep quagmire it found itself in 15 years ago, but the city still has plenty of catching up to do.

Perhaps its biggest problem is its reputation for violent crime and corruption. Last year it was hit by a wave of gangland and drug-related killings. Although the police seem to have stopped these, the Camorra (the Neapolitan version of the Mafia) remains powerful. It did well out of relief money sent to Naples after the 1980 earthquake. If you want to know why the streets of Naples and the roads up Vesuvius are covered with rubbish, the answer lies with this organised-crime group.

And the Camorra is not alone. Calabria has the 'Ndrangheta, reputedly the toughest and hardest-to-penetrate of the southern criminal groups. It is believed to have been responsible for last month's assassination of the deputy chairman of the region, although no clear motive has yet been discovered. Mr Berlusconi was heavily criticised for his failure to speak out against the attack or to attend the funeral. Both the Italian president, Carlo Azeglio Ciampi, and the opposition leader, Romano Prodi, were there.

Cosa Nostra at work

And then there is the Mafia in Sicily. Of all the organised-crime groups in Italy, it is the Mafia that has most directly challenged the state in the past 20 years. The challenge has been partly beaten back, thanks to the bravery of a string of dedicated and hard-working magistrates in Palermo. Many top *mafiosi* have been convicted and jailed, often on the basis of confessions by *pentiti*, former Mafia members who have turned state's evidence. Yet the price has been fearful. Outside the Palace of Justice in Palermo is a moving memorial to the 12 Sicilian magistrates who have been assassinated since the 1980s.

The magistrates have not been overwhelmed by help from Rome. One former (Christian Democrat) prime minister, Giulio Andreotti, was tried but not convicted for complicity with the Mafia; the appeal court said he had merely been “friendly” with it. Marcello Dell'Utri, a close colleague of Silvio Berlusconi, who was intimately involved in the establishment of Forza Italia, was convicted of the same offence, though he has launched an appeal. Magistrates in Palermo believe that the Mafia, which was weakened in the late 1990s, has grown stronger in the past four years, partly because Mr Berlusconi and his friends have undermined the work of the judiciary.

The Mafia certainly adds to the cost of doing business in Sicily. Yet, as elsewhere in the *mezzogiorno*, it is the economy and high unemployment that are the most serious challenges. As Pietro Busetta, an economist in Palermo, puts it, Sicily has 5m people, but only 1m in work—replicating the general southern (and Italian) problem of too low a rate of participation in the workforce. Mr Busetta sets great store by the plan recently approved by the Berlusconi government to start work on a much-discussed bridge across the Messina straits, connecting Sicily and Calabria. Critics see this as a boondoggle that will greatly benefit a few construction companies—and no doubt both the Mafia and the 'Ndrangheta.

One thing on which Sicily should work much harder is its tourist industry. The island ought to be the jewel of the Mediterranean. It has a superb climate, wonderful scenery, an active volcano, delightful beaches and excellent food and wine. Its abundant cultural treasures range from the extraordinarily well-preserved Greek temples and theatres at Segesta, Agrigento and Taormina to the Baroque beauty of Catania and Noto. Even the Mafia tradition might attract tourists to places such as Corleone. And yet, complains Mr Busetta, Sicily gets far fewer tourists than Ibiza, and about the same number as Malta.

Sicily is a paradigm for what is wrong with the *mezzogiorno*, and indeed with the whole of Italy. It has a high-tech cluster near Catania and some good universities. But its tourist industry and its entire service culture are underdeveloped. The same is true right across the south—a region that should have been at least as well placed as Spain to benefit from the boom in European tourism over the past 40 years. In a very Italian way, it has manifestly failed to realise its full potential.

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Reform or die

Nov 24th 2005
From The Economist print edition

Does Italy need a crisis to get things moving?

CAN Italy reform itself, or is it doomed to decline? It is always dangerous to project a trend set by a few years' under- (or over-) performance far into the future. Both Japan and Germany, once thought unstoppable and then, not so many years later, irredeemable, now seem poised to recover, and Britain's sorry post-war performance has been forgotten in the euphoria of the past 15 years. Italy's problems are as deep-rooted as any: its potential growth first slowed some two decades ago, and its demographics have looked ominous for many years.

Alamy

Let's go, but where?

But time can be a great healer. In the long run, Italians' natural flair, inventiveness and creativity should be enough to rescue what is still a rich country in every sense. After all, this is where much of European capitalism began, complete with modern banking and double-entry book-keeping. The country's plethora of small firms and its lack of big companies may seem a weakness right now, but in future it might prove an advantage again, providing flexibility to cope with change.

In the short term, though, there are good reasons for remaining gloomy about Italy. As in the rest of the euro zone, only more so, the country desperately needs structural reforms to liberalise markets, inject greater competition and shake up a bloated, inefficient and sometimes corrupt public sector. Currency devaluation to offset deteriorating competitiveness is no longer an option, and the vulnerability of small manufacturing firms to cheaper imports from Asia, especially China, has become painfully clear.

Faced with such huge structural problems, Mr Berlusconi's centre-right coalition government has done nothing like enough to put matters right. Unfortunately, even if the centre-left under Romano Prodi wins the election next April—which looks likely, but by no means certain—it too will

find that reforms are hard to get past some of the more recalcitrant small parties in its coalition, to say nothing of Italy's entrenched special interests.

In some ways, things may need to get worse before they get better. Giuliano Amato, a canny centre-left politician who served as prime minister in the early 1990s and again in 2000-01, observes that “timing is an essential variable in economic matters.” In his first term he was able to push through a ruthless budget, slashing spending and drastically reducing the deficit, because Italy's ejection from the European exchange-rate mechanism in September 1992 produced a consensus that tough measures were unavoidable. That budget laid the foundation for the measures introduced by Mr Prodi's 1996-98 government to ensure that Italy could join the euro from the start.

Mr Monti at Bocconi University offers a similar conclusion. He says that Italian governments can take tough decisions, but only if two conditions are met: there must be both a visible emergency and strong pressure from outside. In the 1990s, the emergency was the impact of the fiscal position on interest rates and the exchange rate; the outside pressure stemmed from the desire to get into the euro.

Now, says Mr Monti, such a moment of truth is lacking. Italy is suffering from slow growth and a steady deterioration of its competitiveness, but both started long before the Berlusconi government came to office. As for external pressure, the European Central Bank, the European Commission and the financial markets are all doing their best to apply some. But Italian enthusiasm for things European has cooled markedly, and membership of the euro has had the perverse effect of dissipating some of the market signals that might otherwise have forced change.

Italy needs to look to the example of other countries that have successfully introduced reforms, and not just Britain. A more telling case across the Mediterranean is Spain. Thirty years ago, the notion that Spain, as it emerged hesitantly from the Franco era, might set Italy an example would have seemed laughable. The Spanish economy is still far smaller than Italy's, and living standards are lower—but they are catching up. The Socialist government of José Luis Rodríguez Zapatero that came to power in March last year has kept up the momentum of economic reform inherited from its centre-right predecessor.

The gain in Spain

Spain's public finances are also a lot healthier than Italy's, which is one reason why it has been able to afford such impressive infrastructure investments as the high-speed railway to Seville or the burgeoning airport at Madrid (bigger than any in Italy). The biggest Spanish companies, such as its two largest banks and Telefónica, have built up a stronger global presence than their Italian counterparts.

The differences between the two countries are palpable even to the passing visitor. There is a buzz of optimism in Madrid and Barcelona that often seems lacking in Rome and Naples. When the Guggenheim Museum in New York was looking for a new foreign outpost a few years back, a natural choice would have been Venice, which already has a Peggy Guggenheim gallery. But it spent years dithering over the site, so the prize was snatched away by Bilbao in Spain's Basque country.

Italy is not about to be overtaken by Spain. But if it is to stay ahead for long, it needs bolder political leaders who are prepared to override opposition to reform even in the absence of an immediate crisis. At the end of “I Pagliacci”, Leoncavallo's *verismo* opera about Sicily in the 1870s, Canio the clown, who has just stabbed his wife and her lover to death, concludes: “*La commedia è*

finita." It is time for Italy, too, to get serious.

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Sources and acknowledgments

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This survey has drawn on many sources and interviews, not all of them cited in the text. The standard history of post-war Italy is in two volumes by Paul Ginsborg: "A History of Contemporary Italy, 1943-1980" (Penguin, 1990), and "Italy and its Discontents, 1980-2001" (Penguin, 2003). Three other books were also helpful: "The Dark Heart of Italy" by Tobias Jones (Faber and Faber, 2003), "Berlusconi's Shadow" by David Lane (Allen Lane, 2004; the author is *The Economist*'s business and finance correspondent in Italy), and "Silvio Berlusconi" by Paul Ginsborg (Verso, 2004). Other useful sources were the OECD's latest country report on Italy (May 2005), "Italy Today: Social Pictures and Trends" (Censis, 2005), "What Italy Needs to Do" (Goldman Sachs Economics Paper 130, September 2005), "Oltre il Declino" by Tito Boeri and colleagues (Il Mulino, October 2005), and "Italy: a New Commitment to Growth" (Harvard Business School Case Study 703-007, August 2002). The author would like to thank the Italian embassy in London for its assistance.

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Economist.com BUSINESS

Executive pay

Too many turkeys

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Executive pay is on the rise again—and so are complaints that ordinary performance is attracting extraordinary rewards

Get article background

AMERICA'S top executives had plenty to celebrate as they tucked into their turkey this Thanksgiving—a resurgent stockmarket, record profits and, above all, their own ever-expanding pay packets. In the years immediately after the bursting of the dotcom bubble and the scandals at Enron and the like, executive pay fell—at least by some measures. But that, it is now clear, was but a blip, mostly reflecting managers' reluctance to cash in share options in what was then an unattractive stockmarket.

Executive compensation in America—already far ahead of the rest of the world, despite the best efforts of overseas managers to catch up—is now rising inexorably again. In fiscal year 2004 the total compensation of the median American company boss rose in every industry, by between 9.7% in commercial banking and 46.1% in energy, according to a new report by the Conference Board, a research organisation. In the big companies that comprise the S&P 500 index, median total chief-executive compensation increased by 30.2% last year, to $6m, compared with a 15% rise in 2003, according to a study published last month by the Corporate Library, a firm that tracks corporate-governance data.

Recent higher profits are part of the explanation for higher pay. But there is a longer-term trend at work. In 2004 the ratio of chief executives' compensation to the pay of the average production worker jumped to 431 to one from 301 to one in 2003, according to “Executive Excess”, a recent study of 367 big American firms by the left-leaning Institute for Policy Studies. That is not quite a

record: in 2000 the ratio reached 525 to one (see chart). In 1990 the ratio was 107 to one and in 1982 a mere 42 to one. This year's numbers seem certain to show the gap widening still further.

But while unionists and left-leaning politicians are worried about social equity, investors typically have a different sort of concern. They are happy to pay for exceptional performance; but less delighted when mediocre managers get lavishly rewarded. The contrasting cases of James Kilts and Michael Eisner make the point.

Mr Kilts, the boss of Gillette, has publicly accused critics of the $165m bonus he got for selling his firm to Procter & Gamble for $53 billion of “unsubstantiated, inaccurate and irresponsible criticism” and of treating him like a “piñata”—a sweet container that American children bash at parties. Piñata Jim may have a point. He did a lot to restructure Gillette—allowing it to be sold for a fancy price, to the huge benefit of its shareholders. It is when vast payments are the reward for poor performance that it is time to cry foul. Michael Eisner was an outstanding manager during the first part of his more than 20 years at the top of the Walt Disney Corporation. But as Leo Hindery points out in a new book (“It Takes a CEO”), he was also paid $800m over a 13-year period during which the company's shareholders would have done better by investing in Treasury bonds.

All right for some
Ratio of average executive* to average production-worker pay
600
500
400
300
200
100
0
1990 92 94 96 98 2000 02 04
*Includes salary, bonus, restricted stock, payouts on other long-term incentives, and the value of options exercised
Source: Institute for Policy Studies/United for a Fair Economy

The populist end of the debate has led to some action in Congress. Barney Frank, a left-wing Democrat, has just introduced legislation intended to tackle the “problem of runaway executive compensation”. Wisely, he is mostly seeking to improve disclosure, rather than actually to cap pay at a specific level, which experience suggests would encourage creative ways around the cap.

A 1994 reform that limited tax deductibility of executive pay to $1m merely turned the $1m maximum into the *de facto* norm, and inspired the rapid growth of share options as an alternative form of tax-favoured compensation. Some experts now blame the peculiar risk-taking incentives created by share options for many subsequent corporate scandals. Although Mr Frank's legislation is not expected to become law, it is adding to the pressure on the Securities and Exchange Commission to make better use of its powers to demand full disclosure.

Even some businessmen are now calling for restraint. Edgar Wollard, a former boss of DuPont, recently proposed that a chief executive's compensation should be indexed to the pay of the senior vice-presidents that head his firm's divisions. At DuPont, he was limited to 150% of the average pay of those other top executives. Mr Hindery, a serial CEO in the telecoms and media businesses, says he has published his book partly because greed in corporate America is now damaging capitalism.

Many experts see the continuing rise of executive compensation—and the continuing lack of a demonstrable link to performance—as a symptom of a massive failure of corporate governance. Greater pressure from shareholders is generally regarded as the only real antidote. But critics of perceived executive excess have been frustrated by shareholder passivity, which is sometimes blamed on the short time horizons of many investors.

So is there a cure? Certainly, fuller disclosure would help, argues Lucian Bebchuk of Harvard Law School and co-author of a recent book, “Pay Without Performance: The Unfulfilled Promise of Executive Compensation”. If there were proper disclosure of forms of executive pay such as

pensions, supplementary pensions and deferred compensation, then it would be easier for shareholders to see whether chief executives are being rewarded for genuinely good work.

It is the issue of aligning incentives and rewards—rather than the absolute level of pay—that tends to concern professional investors most. “There is no right or wrong number”, says Bob Pozen, chairman of MFS Investment Management, which has $160 billion under management. It is hard to judge the merits of a package without looking carefully at the details, he says, which is why he has little time for Mr Frank's proposal for shareholders to vote each year on the executive compensation package. In Britain, where shareholders now get a non-binding vote on compensation, it has had no real impact, he reckons.

Blame the consultants

Mr Pozen reserves his fiercest ire for the kind of executive pay package that rewards bosses generously even if they fail. And he is extremely critical of the role of compensation consultants. They, he says, tend to be chosen by the chief executive, and to drive up pay by recommending that the top man should be paid more than his peers, having chosen a group of peers whose pay errs on the high side.

Ira Kay, an executive-compensation consultant at Watson Wyatt, strongly disagrees, pointing out that the compensation committee of the board increasingly hires the consultant—a change he regards as “revolutionary”. Moreover, in the past few years many American firms have changed their approach to executive pay, he says, improving disclosure and changing the composition of pay packages so that they provide stronger incentives to manage for the long run. In particular, share-option grants have fallen sharply, while there are more grants of restricted stock (that pay out only over time or when a performance target is hit).

Even so, a survey Mr Kay is working on suggests that there is now as “large a gap as I have seen between what institutional investors and boards think about executive compensation”. Boards think they are doing a good, shareholder-friendly job; institutional investors do not. Mr Kay fears that if the institutions do grow more militant about executive pay, there is a “risk of a return to the 1970s”, with bosses paid like bureaucrats and talented managers seeking more rewarding work elsewhere.

That would indeed be a bad thing. But judging by recent trends—and the continuing failure to reform board elections to make it easy for shareholders to vote out directors who are too friendly to management—hell is more likely to freeze than bosses' pay.

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Economist.com BUSINESS

Intellectual property

Black and Blue

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Drop that BlackBerry now

IT IS addictive and anti-social—but could using your BlackBerry also be illegal? An American judge is poised to rule whether the ubiquitous BlackBerry wireless e-mail service should be shut down in the United States, as part of a bitter intellectual property lawsuit. Over the past four years the number of BlackBerry users has risen from 300,000 to more than 4m. The devices have become so popular that they help keep the global economy humming, by enabling millions of professionals to work from anywhere. Now white-collar workers face the grisly prospect that, with their BlackBerries out of commission, they may have to pay attention to their children, rather than their e-mail.

In 2002 Research in Motion (RIM), the Canadian firm that makes the gadgets as well as the back-end software that manages the system, lost a patent infringement suit to NTP, a company that comprises little more than a handful of lawyers and the patents of Thomas Campana, an inventor who earned more than 50 patents on wireless-data systems before dying last year. RIM was ordered to pay damages (around 8% of sales in America) and an injunction to halt BlackBerry service in America was postponed pending appeal.

The appeals court watched as RIM and NTP negotiated a settlement for $450m in March 2005; a joint press release was duly issued. But by June the deal unravelled; neither party will say why. In October the appeals court issued its decision largely reaffirming RIM's infringement. So the injunction to halt BlackBerry service looms. This month America's Department of Justice asked the court to ensure that BlackBerry service continues for government employees, particularly congressmen, who have come to rely on it.

Yet it still seems likelier that a deal will be reached than that the BlackBerry will go dark. RIM claims it can upgrade the system with a new technical “work-around” that offers the same services, without treading on the NTP patents—which have anyway recently been thrown into doubt by America's Patent Office. And a financial settlement may yet be agreed: this week RIM asked the court to enforce the $450m deal. It seems strange that such a massive sum should go to a small, unknown firm. But courts have consistently looked at the evidence and so decided. Perhaps that is the price of protecting ideas.

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Economist.com BUSINESS

Regulating chemicals

No thanks, we're European

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A piece of European legislation that will affect industry across the world

EPA

Stupid Strasbourg stunt

MOLLIE the toxic child was in Strasbourg last week as part of a campaign to stiffen European rules on the import and production of hazardous chemicals. A study by the WWF last year found 35 toxic chemicals in Mollie's blood, and similar levels in 13 families tested in 12 European countries. She was in Strasbourg to persuade members of the European parliament to vote green. That is the emotive side of a gigantic clash between industrial interests and proposed European Union legislation designed to minimise citizens' exposure to hazardous chemicals—in their cars, homes, work and playgrounds.

The plan is to subject up to 30,000 substances to a procedure known as REACH (registration, evaluation and authorisation of chemicals). The European Commission produced a proposal in 2003, since when industrial, consumer and environmental groups have been lobbying hard. A consultation in 2003 led to 968 written responses, of which 587 alone came from Germany, the home of thousands of small companies that handle complex materials. All companies involved in mining, processing, manufacturing or assembly inside Europe, or with the European market in mind, could be affected by REACH.

For that reason, lobbyists have included mining and processing interests in Australia, Canada, Chile and sub-Saharan Africa, to name just the most vocal. American business associations have also complained that the EU proposal cuts across broader plans by the OECD and the World Trade Organisation. Small businesses worldwide may be shut out of Europe by the cost of compliance, many fear. An EU estimate of the cost to industry of abiding by the new regulations ranges from €2.6 billion ($3.1 billion) to €5.2 billion over 11 years. But the EU sees savings on the other side of the ledger—by limiting exposure to hazardous materials, it foresees savings in health-care costs of as much as €50 billion over the next 30 years. Even giant chemical companies agree that it would be useful to know more about the chemicals people are exposed to. Of the 30,000 substances identified by REACH, only about 10% have been studied in any detail, says the WWF.

But while most people can accept the need for some legislation, they disagree on precisely what it should say. There have been bitter disagreements, even within the EU bureaucracy. The original REACH proposal was drafted by the commission's environment directorate, which was strongly influenced by the likes of WWF. But the enterprise and industry directorate—led by Günter Verheugen, the German vice-president of the commission—has been fighting for the interests of industrialists. The draft REACH regulation, which European parliamentarians voted for by 407 to 155 on November 17th, contained more than 1,000 proposed amendments, of which fewer than 300 survived.

The result pleased neither industrialists, nor greens. Consumer groups complained that REACH's original concept had been watered down—for example by waiving the registration of any substance imported in quantities of less than one tonne a year. Moreover, many other substances would require no more than registration. The priority for screening potentially hazardous substances would be set by volume rather than by other measures of risk—which was the original plan.

The chemical industry was disappointed too, by a rule that hazardous substances will be authorised for at most five years, after which business must find a substitute, unless it can establish some “socio-economic justification”. Five years is too short argues Utz Tillmann, who works on environmental issues at BASF, Europe's biggest chemical company. It took BASF ten years to persuade the car industry to favour a plastic fuel tank over one made of steel, he recalls.

Handlers of non-ferrous metals on the other hand were pleased that ores and concentrates escape the new rules. So do oil-based plastics—because they would have overwhelmed a new European Chemicals Agency due to be set up in Helsinki to handle REACH. Metals traders are forming consortia to standardise the treatment of metals held in warehouses the world over for delivery against futures contracts—fearing that a two-tier market might otherwise develop, one inside the EU and one outside.

At every turn, REACH threatens to trigger unintended consequences. Sandra Carey, of the British non-ferrous-metal lobby, sees it as the EU's most important legislation ever. Her greatest concern is that an over-extended REACH would raise barriers around Europe and suck raw materials and manufacturing in the direction of India and China.

Nevertheless, the EU Council of Ministers, which will be chaired by Britain until December 31st, seems determined to secure a final agreement on REACH by the end of the year. The British are generally wary of burdening industry, but are keen to add some shine to an otherwise lacklustre six-month presidency. Germany won some breathing space this month to give its new government time to review the draft. But EU ministers are due to meet on December 19th and will either accept the parliament's amendments or challenge them and send the bill back for a second reading. The lobbying goes on.

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Economist.com BUSINESS

The digital home

Boxed in

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Big technology vendors are piling into people's living rooms

IT HAS been quite a week for the “digital home” that so excites technology vendors. On November 18th, Cisco, the world's largest maker of the routers and switches that direct internet traffic, said that it would pay $6.9 billion to buy Scientific-Atlanta, the second-largest maker (after Motorola) of the television set-top boxes that unscramble the signals of cable operators. Then SBC became America's largest telecoms company by completing the acquisition of its former parent, AT&T, promptly giving itself a lower-case “at&t” logo and reaffirming its strategy to transform itself into a provider of on-demand video services, delivered over internet links. TiVo, a maker of digital video recorders, said that it would add software to let users transfer saved TV shows on to iPods. And Microsoft announced a new version of its Xbox game console (see article).

Behind all these events is the widespread belief among technology companies that consumers, rather than companies, are their best remaining hope of returning to the revenue growth seen during the dotcom boom of the 1990s. The consensus is that consumers will use one pipe—their internet connection—not only for their web surfing and telephony but also for their films; and that, having pulled their entertainment from the internet, consumers will then beam it to any screen or room in the house over supposedly “seamless” wireless home networks. This, in marketing circles, is called the “digital” or “connected” home.

Behind these hopes lies a lot of desperation. Telecoms firms are in trouble because their fixed-line business is shrinking, and because their cable rivals are beating them in entertainment while getting stronger in telephony. Like telecoms firms elsewhere in the world, AT&T and its arch-rival Verizon are fighting back by laying new fibre-optic cables in the ground so that they can provide the bandwidth necessary to carry television over internet protocol (or “IPTV”). Their goal is to provide a “triple-play” bundle of data, voice and video (or even a “quadruple-play” including mobile-phone service)—presumably so that customers can never escape them again.

Hence Cisco's attempts to follow the service providers and break out from the bowels of the internet into the plain sight of living rooms. In 2003 Cisco bought Linksys, a firm that makes gadgets for home computer networks. The deal with Scientific-Atlanta is a natural next move. The idea is that Cisco's gadgets will become the end-point of the internet-video services offered by the telecoms and cable companies. Once video from an IPTV service has been saved on to the hard drive of a set-top box, the same gadget could use Linksys technology to beam the video to speakers and screens in other rooms.

The cliché for all this is “convergence”—the folding of several separate services (voice, television, data) into a single stream of zeros and ones, sent using internet protocol. But “collision” is probably a better description, says Pip Coburn of Coburn Ventures, an investment adviser. “The vendors are all scrambling and steadily butting heads more and more,” he says. “Cisco is inches away from a major battle with Microsoft now.”

Not officially, mind you. Microsoft has tactical or defensive stakes in all parts of the digital home,

so it has partnerships with the telecoms companies and with Cisco. But Microsoft is really hoping that the “hub” of tomorrow's digital homes will be a computer running the “media-centre edition” of Windows (in effect, Windows with a remote control). As second-best, Microsoft would like its Xbox console to become the control centre of the digital home. In short, Microsoft wants anything but the boxes offered by other companies.

Then, of course, there are Apple, Sony, Motorola and Yahoo! Each of these firms is also trying to secure a lucrative place in the digital home. The result, for the time being, is a tug of war among incompatible digital-copyright codes that leaves consumers, who simply want things to work, confused or indifferent. The digital home is likely to remain a dysfunctional one.

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Advertising

On the mat

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Direct mail is losing its effectiveness

AS MUCH as people hate it, junk mail works—otherwise they would not send you the stuff. Unlike television or newspaper ads, the return on investment from a direct-mail campaign can be accurately measured. Even though only a small percentage of people may read the material, the response rate has been high enough to make junk mail one of the most cost-effective forms of marketing. But that could be changing.

One of the biggest users of direct mail is the financial services industry, which spent around $2.5 billion on mail shots in America last year. Unfortunately, people seemed less interested than ever in signing up for new credit cards or insurance policies. The response rate from some campaigns has fallen to just 1.4%, according to America's Direct Marketing Association (DMA). In previous years it was well above 2%. When it comes to responding to “direct-order” mail shots (signing up to an offer, as opposed to merely expressing an interest), the rate has fallen even more dramatically, to 0.7% from 3.5% in 2004.

The problem seems to be too many envelopes cluttering too many mail boxes, “leading many consumers to discard the blizzard of solicitations they receive”, according to *Advertising Age*. The trade publication says firms must target their mail shots better. But that costs more money. It could mean buying a list of potential customers.

But why write when you can ring? Despite “don't call” lists, when it comes to soliciting a sale the phone produces the highest response rate, at an average of 8.6%, according to the DMA.

Some of the dodgiest marketing outfits now use the phone to tout their offers. In Britain, the latest trick is to use automatic dialling machines to call mobile phone numbers at random, but then to hang up after just one or two rings. Seeing a missed call, the unsuspecting recipient will usually ring back just in case it is something important, only to be greeted by a sales pitch. Getting the customer to pay the cost of cold calls takes real *chutzpah*.

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Economist.com BUSINESS

Aviation

Half-open skies

Nov 24th 2005
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Why the Americans are happy and the British are moaning

AT FIRST sight it looked like an historic breakthrough for free trade in aviation. After ten years of trying, negotiators in Washington agreed on November 18th to press ahead with an “open-skies” deal liberalising air traffic between the European Union and the United States. Since these two markets together account for more than half of world traffic, this would be a great achievement. But, while the Washington deal would be a big step forward, genuinely “open skies” are still some way off.

If ratified on both sides of the Atlantic, the tentative deal would replace a patchwork of national bilateral open-skies deals already in existence between America and 15 EU countries with one agreement between the United States and the EU as a whole. It would mean that any American airline could fly to anywhere inside the 25-member EU and vice versa. The Americans are delighted because it means that far more American airlines can expect access to London Heathrow, the world's busiest international airport. And European airlines see two possible benefits. First, it will be easier for them to buy a stake in an American airline. Second, they will be able to fly from anywhere in Europe to the United States—so that Air France, for instance, could fly to Washington from London, and British Airways could compete with Lufthansa on the Frankfurt-New York route. This abolition of national flag carriers will, in turn, make it easier to complete cross-border European airline mergers.

The models for the EU-US agreement are the various deals that America has signed around the world with 58 countries in addition to EU countries. The merits of these are that they allow any airline to fly where and when it wants between two countries, with no limits on capacity or need for official approval of fares. But these deals stop short of opening up the market in America—internal flights operated by foreign airlines are still off-limits and foreigners are also limited to owning 25% of the voting rights of a domestic airline (Europe is a little more liberal, with a 49% limit). They are more like “liberalised mercantilism” than real free trade, in the words of one executive closely involved in the recent talks.

America now is promising to loosen the ownership rule by reinterpreting it so that foreign nationals can actually run an American airline, although the 25% limit would remain. This is as far as the administration can go without needing approval from Congress. Many Europeans in the business think this “concession” is not worth all that much. Even so, some airlines in America are already lobbying to get the administration to withdraw it.

Most European countries were quite happy to get any sort of deal with the United States. But not Britain, since it will now be compelled to open up Heathrow for the first time to any American carrier that can buy landing slots on the grey market. In theory, any other EU airline could also now try to elbow into Heathrow for transatlantic flights, if it could acquire suitable slots. Hitherto, Britain retained a particularly restrictive traffic agreement with America and only American Airlines and United have been allowed access to Heathrow for transatlantic flights, alongside British Airways and Virgin Atlantic.

It was therefore unsurprising that the British pair were moaning this week that Brussels had sold the pass by failing to wring more concessions from America. Although previous liberalising deals have fallen through, British carriers are gloomily reconciled to the fact that this one, after several months more haggling, could actually be sealed.

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Economist.com BUSINESS

Airport cities

Business on the fly

Nov 24th 2005 | DALLAS-FORT WORTH
From The Economist print edition

How airports act as a hub for business development

IN THE 19th century cities and businesses grew up around the railways; in the 20th century the growth of motorways drove development. But these days the magnets for business are airports. With so much emphasis on just-in-time manufacturing and some professionals needing to jump on planes almost daily, airports are becoming the centres of cities of their own. Warehouses, malls, high-tech firms and even consultancies are setting up shop almost within sight of the runway. It is a phenomenon that John Kasarda, a professor of entrepreneurship at the University of North Carolina calls the “aerotropolis”.

One such aerotropolis has grown up around Dallas/Fort Worth International Airport (DFW). Jeffrey Fegan, the airport's chief executive, illustrates the phenomenon with a large aerial photograph that has his airport at the centre. Dense clusters of buildings appear on all sides, just beyond the highways that ring the airport. DFW opened in 1974 and is set squarely in the middle of the two huge metropolitan areas that give it its name (see map). But much of the surrounding development has taken place over the past ten years. The immediate airport area has all the facilities travellers expect—rental-car agencies, hotels and cargo storage—as well as the headquarters of American Airlines. Warehouses are on all sides; the latest arrival is Amazon.com, which plans to open a giant plant later this year in the city of Irving, just a 15-minute drive from the airport. A new shopping mall is due to open south of the airport.

Irving used to be known mostly as a home to Texas Stadium and the Dallas Cowboys. But Las Colinas, a planned business and residential community within Irving, now boasts offices belonging to household names such as Accenture and Bank of America. In May Fluor, a giant engineering company, decided to move its corporate headquarters from southern California to Las Colinas. It cited the proximity of DFW as a “major factor” in its decision.

Dallas is far from an isolated example of airport-driven development. When Washington Dulles International Airport opened in 1962 in rural Virginia, it was considered a white elephant; but it has spawned a high-tech corridor and now sits in the fastest-growing county in the United States.

Denver's ten-year-old international airport, about 40 miles out of town, is expected to be the centre of a community of 500,000 people by 2025—almost as many people as live in Denver itself. It recently branded its surrounding acreage as the “Aeropolitan”, a nod to Mr Kasarda, as well as a marketing pitch to businesses.

Working in the shadow of an airport has its problems. There are height restrictions on buildings, and residents and office workers have to put up with the noise and traffic that airports generate. But, despite those drawbacks, more and more businesses feel the need to be near a runway.

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Economist.com BUSINESS

Face value

God's media mogul

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AP

Philip Anschutz, an oil and telecoms billionaire, wants to bring morals to Hollywood

HAVING amassed a fortune when still young, many businessmen turn their attention in later life to charitable works for the benefit of society. Few, however, have as ambitious a vision as Philip Anschutz, a religious billionaire whose aim is no less than to uplift American culture. Mr Anschutz has set up a studio to make moral films for families of a kind he says Hollywood neglects. His most expensive effort yet will be released on December 9th: “The Lion, the Witch and the Wardrobe”, a $150m adaptation of a book by C.S. Lewis.

“Four or five years ago I decided to stop cursing the darkness—I had been complaining about movies and their content for years—and instead to do something about it by getting into the film business,” Mr Anschutz explained in a speech last year. He reckons that making family fare free of sex and violence is a shrewd business strategy too, and a way to cope with the notoriously hit-or-miss nature of the film industry. Of the top 50 moneymaking films of all time, he points out, only five are rated for adults only—but Hollywood has made only 389 films open to all the family, out of the 2,146 produced since 2000.

A 66-year-old conservative Republican from Colorado who never gives interviews, Mr Anschutz made his first fortune drilling for oil. He later bought up railways, laid fibre-optic cable along the tracks and built Qwest, a public telecoms company. When Qwest announced improper accounting in 2002, in the midst of a series of corporate scandals, angry shareholders proved nothing against Mr Anschutz, although he attracted criticism for having soldQwest shares in 2001. He holds his movie interests privately, along with a number of sports teams, live-entertainment venues and America's largest chain of cinemas.

To the gratification of Hollywood insiders, who relish the sight of a rich man coming to town with

notions about film-making, Mr Anschutz has had mixed financial results from his movies so far. He is spending his own money and has yet to score a really big hit. A smallish film about one of his favourite musicians, Ray Charles, performed well and won awards. Another, “Around the World in 80 Days”, cost more than $100m and flopped. “He hasn't proven himself yet,” says an executive at a big Hollywood studio. “He's had no outright commercial successes and there have been some failures.”

With “The Lion, the Witch and the Wardrobe”, however, Mr Anschutz is likely to demonstrate that he is more than just a wealthy eccentric. The film is expected to make hundreds of millions of dollars, partly because it has enormous appeal to Christians. It could also be the first of a valuable franchise, as Lewis wrote six more books in the Narnia series. Big studios used to stay away from overtly religious films for fear of alienating a part of the audience, until “The Passion of the Christ”, a film in 2004 about Christ's crucifixion. Its box office takings—$370m so far—prompted a hasty conversion in Hollywood, and religious themes are firmly in fashion.

Mr Lewis's book describes Christ's crucifixion in an allegory, through a lion who dies and returns to life. Mr Anschutz's production company, Walden Media, has brought in Disney to share half of the cost and profits from “The Lion, the Witch and the Wardrobe” and to do its marketing. To get church congregations out to see it, the two companies have hired Motive Marketing, a specialist promotion company whose efforts with churches helped make “The Passion of the Christ” a hit.

Now churches are waiting to see how religious the film will dare to be. It is possible, after all, for a child to read the book and not spot its message. Christian blogs worriedly discussed recent comments from the English actress who plays the book's evil witch, Tilda Swinton, who said the book is based as much on ancient myth as on the story of Christ. Dick Cook, head of Disney's film studio, points out that only 5% of the film's marketing budget has gone on outreach to churches.

Get them when they're young

As well as its film-making division in Los Angeles, Walden Media runs an office in Boston which tries to persuade teachers to use its films in classrooms. It is a partner in a school campaign in Florida to get children to read, and the latest book in the programme is—surprise!—“The Lion, the Witch and the Wardrobe”. Hollywood is especially impressed by Walden Media's education strategy. Studio executives see it as a clever way to get children and parents to buy its products. Authors also often like the idea of cross-promoting films and books. Now Walden Media is trying to bring its education concept to Britain, where Mr Anschutz wants to expand. He has bought the Millennium Dome in London and plans to make several films in Britain.

Mr Anschutz's very latest media venture is free newspapers. He bought the *San Francisco Examiner* in 2004, later launched a Washington edition and has trademarked the *Examiner* name in more than 60 cities. In October he announced he will start another *Examiner* in Baltimore in 2006. Mr Anschutz's innovation in free newspapers is to deliver them to high-income homes, rather than distribute them randomly to commuters.

The *Examiners'* editorials have taken right-of-centre positions, robustly defending Samuel Alito's nomination to the Supreme Court, for example. But because the company that runs the papers, Clarity Media, is privately held and releases no numbers, it is difficult to gauge how Mr Anschutz's latest venture is striking the balance between the profit motive and the general desire to improve the moral climate in the United States.

“The Lion, the Witch and the Wardrobe” faces strong competition from two other films coming out at around the same time: the latest Harry Potter instalment and a remake of “King Kong”. But if the film performs as well as many expect, it will be a blessing for Mr Anschutz, his media

companies—and his values.

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Economist.com BUSINESS

Microsoft

Way beyond the PC

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Reuters

The launch of the Xbox 360 highlights Microsoft's march into new markets

Get article background

IT TOOK place only a few hundred miles from Microsoft's headquarters in Redmond, Washington, but the introduction of the Xbox 360 games console in the Mojave desert this week was light years away from the company's usual product launches. The festivities began on Sunday evening in a remote aircraft hangar, bathed in white and green light, at an event attended by thousands of gamers who had won tickets online. Fans posed for pictures and asked for autographs from Microsoft executives, who were treated like rock stars, before rushing into the hangar to play on hundreds of consoles connected to high-definition screens. Then on Monday, thousands of shops around America opened at midnight to sell the console. Gamers queued in the rain in New York and braved dense fog in Seattle.

It is all a far cry from Microsoft's typical fare. There was no mention of installers, security patches, service packs, server protocols, operating-system monopolies or consent decrees. And that is precisely the point. The Xbox 360, which will be launched in Europe and Asia next month with an enormous marketing campaign, is the most visible example to date of Microsoft's march into new markets beyond its traditional business of making software for desktop and server computers.

Microsoft has been trying for years to move beyond the PC, and into other devices such as mobile phones, television set-top boxes and games consoles. “The big über-strategy that this falls under relates to what's happening in the home,” says Robbie Bach, Microsoft's “chief Xbox officer” and head of a newly formed business unit that brings together Microsoft's gaming, mobile and TV divisions. “We identified many years ago that the digital revolution was going to have a big impact, and we see a big opportunity there,” he says. As all these other electronic devices increasingly resemble computers, they offer Microsoft new opportunities to sell software. Just as

importantly, they offer new avenues for growth: sales of non-PC devices are growing much faster than sales of PCs. “Microsoft wants the next 30 years to be as successful as the last 30 years, so we have to continually find new market opportunities,” says Christine Heckart of Microsoft's TV division.

But there are other reasons why Microsoft is entering these new fields, say analysts. “Microsoft mainly got into these businesses as a defensive measure,” says Matt Rosoff of Directions on Microsoft, a consultancy. “They were concerned that the Sony PlayStation was going to usurp what Microsoft sees as the PC's rightful place as the home hub, the gateway to the outside world.” Microsoft's move into set-top boxes was also defensive, says Mr Rosoff: “If the market moves towards the idea of using the set-top box as a hub, Microsoft wants to be there.” The same logic applies to mobile phones, which far outsell PCs and are coming to be regarded as universal remote controls for living.

Moving into non-PC markets also provides a hedge against any future decline in Microsoft's core Windows and Office franchises—though, despite years of speculation, neither seems to be in any danger of being undermined by open-source alternatives. And in the case of gaming in particular, notes Paul Jackson of Forrester, a consultancy, Microsoft has a chance to rebrand itself as a younger, cooler company. “It's hedging, it's diversification, it's branding, it's getting off the desktop and into pockets and on to TVs,” he says. (Mr Bach denies that rebranding is part of the rationale for Microsoft's push into gaming, but concedes that “the effect is absolutely real and is a nice benefit”.)

Despite, or indeed because of, its success in PC software, Microsoft has struggled for years to break into these other markets. Its Windows monopoly was of no use outside the PC market, and while its hold on the market provided a war chest, Microsoft was hampered by its reputation as a monopolist. The leading mobile-phone companies formed a software consortium to keep Microsoft at bay. Cable companies were wary of using its software in set-top boxes, fearing that Microsoft would transform itself into the gatekeeper of their networks. And Microsoft's hurried and belated entry into the gaming business in 2001, with the launch of the original Xbox, and its insistence on direct control over its online-gaming service, prompted widespread scepticism. But it is now clear that after years of effort, Microsoft is finally making progress in all three markets. What changed?

Playing to win

Start with the Xbox. Since launching its first console in 2001, Microsoft has sold 22m units worldwide, putting it in distant second place behind Sony's PlayStation 2 (which has sold 92m units since its launch in 2000) and just ahead of Nintendo's GameCube (which has sold around 19m units), according to figures from Forrester.

The games business is cyclical: every five or six years, a new generation of consoles appears to slug it out in the market. Success in one round does not guarantee success in the next, when the battle begins anew. (Just ask Nintendo, which ruled the industry for a decade until it was dethroned in 1995 by Sony.) The industry also follows a razor-and-blades model, breaking even on the console hardware but making money on the sale of games, with a licence fee of $10 or so from each game sold going to the console-maker.

Microsoft is thought to have lost around $4 billion on the original Xbox—equivalent to a subsidy of nearly $200 for every console sold. Its venture into gaming would appear to have been an expensive failure. But Mr Bach disagrees. He prefers to regard the billions spent on the original Xbox as an investment that provided Microsoft with three assets: a prominent position in the marketplace, several strong franchises (such as the “Halo” series of games) and an impressive online-gaming service, Xbox Live. “Now our job is to turn that asset value into income statement

value," he says. And Microsoft is indeed widely expected to do far better in the next console cycle, for a number of reasons.

For a start, the new Xbox 360 is launching several months before its main rival, Sony's PlayStation 3, which is expected to appear in Japan next spring and in America only later in the year. (Nintendo's next console, the Revolution, is also due in 2006.) One of the reasons the PlayStation 2 did so well was that it got to market before its rivals, which never caught up. Microsoft hopes to mimic that trick with the Xbox 360. And after the original Xbox flopped in Japan, Microsoft has wooed Japanese games-publishers, hoping to counter the advantage enjoyed by its two main rivals.

Another huge change, says Mr Bach, is that the original Xbox was built from off-the-shelf parts. This reduced time-to-market—the Xbox took 18 months to design and launch—but prevented Microsoft from reducing the cost of the console during its lifetime. With no loss of performance Sony, for example, has gradually reduced the number of chips inside the PlayStation 2, cutting costs and enabling it to sell the consoles at a profit. Microsoft's use of multiple chips from different suppliers (such as Intel and Nvidia) made such integration impossible. But the Xbox 360 is based on a new, custom design that should give Microsoft the flexibility to integrate components in future. As a result, says Mr Bach, the company will break even on the hardware over the console cycle. Since software sales will be profitable, the Xbox 360 should actually make Microsoft money.

Microsoft also has a strong lead in the emerging field of online gaming. Games publishers initially resented Microsoft's decision to centralise control of Xbox Live, in which Microsoft acts as a matchmaker between players. But the system is so slick and seamless that they have since put aside their objections. (So impressive is Xbox Live, indeed, that users may wish that their PCs handled downloads, updates and networking as effortlessly.) Xbox Live allows classic arcade games, game trailers and upgrade packs to be downloaded, and points the way to online delivery of games, and even "episodic" gaming, in future.

Reuters

Dan's a happy fan

Finally, there is the Xbox 360's tight integration with PCs running Microsoft Windows. Microsoft does not see the Xbox as a replacement for the PC, of course, but rather as its ambassador in the living room, able to pipe music, films and photographs to the television. Whether consumers really want to do this sort of thing is unclear, but the inclusion of non-gaming functions in the Xbox can, at least, help gamers justify the purchase to their families, notes Mr Bach.

The upshot is that Microsoft is generally agreed to be in a strong position to challenge Sony's dominance of the industry. Sony looks vulnerable: it is in strategic disarray and Howard Stringer,

its new boss, is struggling to return the company to profit. Furthermore, the PlayStation 3 is based on two ambitious new technologies, the Cell chip and Blu-ray disc drive. If teething troubles delay the console's launch, Sony will have an even bigger fight on its hands.

An uninvited guest no longer

Gaming is not the only new market where Microsoft is making progress. “After years of being the uninvited guest at the mobile party, it seems Microsoft is finally getting its act together in mobile,” notes Jane Zweig of the Shosteck Group, a consultancy. This is a remarkable turnaround, given the way the industry initially clubbed together to keep Microsoft out. In 1998 the world's biggest handset-makers formed a consortium, called Symbian, to develop smartphone software. Their aim was to avoid the fate of PC-makers, which have ended up as commodity box-shifters while Microsoft supplies the software and creams off the profit.

Microsoft got its first foothold in the mobile industry by going behind the handset-makers' backs to their customers, the mobile operators. Its opportunity came as operators started to embrace “operator specific” handsets as a means of differentiating themselves from their rivals. These handsets are built by faceless “original design manufacturers” (ODMs), mostly in Taiwan, and are sold under the operators' own brands. Microsoft encouraged ODMs to develop phones based around its Windows Mobile software. In 2002 Orange, a European operator, launched a Windows-based smartphone built by HTC, one of the leading ODMs. Since then, several other operators have followed suit, attracted by the high data revenues generated by Windows-based smartphones, which support web-browsing, e-mail and other functions. “Operators love data revenue—it's what's giving them growth,” says Pieter Knook, the head of Microsoft's mobile division.

In 2003, Motorola, the second-largest handset-maker, left the Symbian consortium and licensed the Windows Mobile software. The trouble with Symbian, from Motorola's point of view, was that it was dominated by Nokia, its larger rival. So Motorola decided to use Symbian software in some of its smartphones, and Windows Mobile or Linux, the open-source operating system, in others. Another trend in Microsoft's favour was the incorporation of mobile phones into handheld computers, many of which run Windows. Microsoft also won a symbolic victory in September, when Palm, Microsoft's longtime rival in the field of handheld computers, said it would make a version of its Treo smartphone based on Microsoft's software, rather than the Palm OS software it developed in-house.

The upshot is that there are now more than 100 Windows-based smartphones available from 42 device-makers and 93 mobile operators in 55 countries, by Microsoft's reckoning. “Microsoft still has a steep hill to climb—it is still viewed as an outsider in the mobile industry,” says Ms Zweig. But the trend to make mobile phones more like pocket computers plays to Microsoft's strengths, she notes. “We've got a lot of momentum on our side,” says Mr Knook. Paradoxically, the rise of the BlackBerry could also boost Microsoft's fortunes, since it has established a new market—for mobile e-mail devices—in which Microsoft can attempt to undercut the incumbent, Research in Motion.

Worth watching?

The third new market in which Microsoft is advancing after years of struggle is television. Initially, as with mobile phones, Microsoft was frozen out: cable operators, having witnessed Microsoft's monopolistic practices in the PC business, refused to adopt its software in their set-top boxes. Microsoft even bought equity stakes in some cable operators with the aim of improving its bargaining position, to no avail. But lately it has found a way around the industry incumbents. The

opportunity has arisen because telecoms operators around the world are moving into television.

They are doing so mainly because cable operators have started to offer voice services (often bundled with broadband access and television service into a “triple play” package), so the telecoms operators, which already sell telephony and broadband, are responding by adding television too. Television also represents a new market with the potential for higher margins than telephony, the price of which is rapidly falling to zero. But telecoms firms do not, by and large, own cable networks; instead, they must deliver television signals over copper telephone wires, just as they now deliver broadband access. Delivering TV over broadband in this way is called “internet protocol TV”, or IPTV. In addition to traditional television, IPTV can support new forms of interactivity, and video-on-demand services.

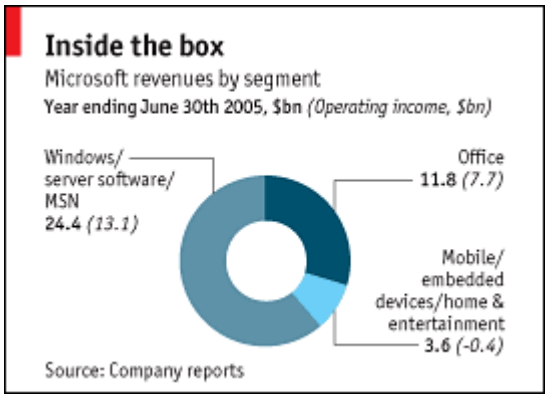
Microsoft has quickly established itself as one of the leading providers of IPTV technology, working in partnership with Alcatel, which supplies the hardware. Microsoft's IPTV software is being used by SBC (which has just renamed itself AT&T), BellSouth, Bell Canada, BT and Telecom Italia, among others. Since IPTV is a new and unproven technology, says Peter King of Strategy Analytics, a consultancy, telecoms operators are reluctant to build entire systems themselves. Hence the appeal of going with Microsoft instead: IPTV is largely a matter of software, and Microsoft has the resources to stay the course. Andrew Burke, the head of BT's new entertainment division, says BT chose Microsoft's technology in part because so many other telecoms firms are adopting it.

“The IPTV industry has moved enormously fast,” says Ms Heckart. “In two years, it has covered the ground the cable industry covered in 20 years.” Too fast, say some. Several planned deployments of IPTV have been delayed this year due to teething troubles with the technology.

The question is not whether IPTV will start working, but when. Next year, seems to be the general consensus. It will be only a subset of the TV market, but unlike with mobile phones and gaming, Microsoft will be there from day one. “In IPTV, we are leading in a brand new, very exciting market,” says Ms Heckart.

So Microsoft is, in short, finally making headway into three important non-PC markets. Does this signal a new direction for the company, akin to Apple's reinvention of itself as a sexy consumer-electronics firm, courtesy of the iPod? Actually, no—or at least, not in the foreseeable future. Microsoft's gaming, mobile and television divisions have yet to make a profit. Microsoft makes profits of roughly $20 billion a year on revenues of $40 billion, the vast majority of which comes from its Windows and Office franchises (see chart). In its most recent financial year, its non-PC division had revenues of $3.6 billion, and made a loss of $440m. The company hopes its non-PC division will become profitable in the next financial year, but so far it is a flea on the back of the Windows/Office elephant.

And it seems likely to stay that way. Even in the best case, says Michael Pachter, an analyst at Wedbush Morgan Securities, the gaming business will go “from being a big drain on earnings to being earnings neutral”. Microsoft would be very happy if it sells 30m Xbox 360s by 2011, he says, and ecstatic if it can sell 40m. On average, the “tie ratio” (the number of games sold per console) for the PlayStation 2 is 11; matching that would mean sales of 440m games, with Microsoft taking a $10 licence fee on each one. Assuming the hardware is sold at break-even, that means $4.4 billion in software revenues over five years, or $880m a year, from which the costs of running the gaming division must be



deducted. In all, says Mr Pachter, Microsoft will be lucky if it makes $250m a year from its gaming business.

Similarly, says Mr Jackson, Microsoft is unlikely to make any money from mobile devices. “Given the licence agreements they have been forced to adopt to match Symbian and Linux, the revenue from mobile will always continue to be tiny,” he says. Mr Knook counters that mobile devices generate sales for other parts of Microsoft's business, such as mail servers, which do not show up on the balance sheet for his division. The same is true of IPTV: there is probably not much money to be made in set-top boxes, but it could help to boost sales of server software.

Follow that

It must be galling for Microsoft that no new market it enters could possibly be as lucrative as the operating-system business—a business that has, after all, been declared an illegal monopoly in both American and European courts. Few legal businesses are as profitable as Microsoft's Windows business, notes Mr Rosoff. “They'll never find another market with those kinds of margins,” he says. Microsoft got in right at the start of the PC business, prospered as a result of its rapid growth, and is still able to sell a copy of its software with almost every one of the 200m PCs sold each year.

In contrast, Microsoft is coming late to these other industries, has a much smaller market share in each case, and cannot extract as large a tax on each unit sold. The best justification for its move into other markets, then, is to protect and reinforce the profits of its core business. “If they can use these other devices to keep those profits rolling in, then that's justification enough,” says Mr Jackson.

Even Microsoft's Mr Bach seems to agree. Of the teams working on new devices, he says, “nobody is trying to create the next Office and Windows business. Those businesses are very hard to replicate, because of the level of market success.” Microsoft, now a middle-aged company, has shown that it is still capable of moving into new markets, even when its Windows monopoly provides no direct advantage. But it is difficult to imagine how any of them could enable it to recapture the glories of its youth.

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Economist.com FINANCE & ECONOMICS

Europe's single market

Banking on McCreevy

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The EU's internal-market commissioner wants fewer, but more consumer-oriented, new regulations for financial services

FEW people with a stake in the European Union's financial markets are neutral on the subject of Charlie McCreevy. The former Irish finance minister, now the EU's internal-market commissioner, is regarded as both a sensible champion of capitalism and a bureaucrat who has slowed the march towards a single market. But he is also seen as an enforcer who roughs up member states that don't toe his line—pity his spokesman, who says, only half in jest, that Mr McCreevy wants to make him the least popular man in Brussels.

The sensible McCreevy is likely to be on display in a new financial-services plan for the next five years, due to be laid out by the European Commission on December 5th. The “White Paper” is sparing in its new proposals—a relief to financial firms groaning under a glut of past initiatives from the Brussels rule factory. In return, McCreevy the enforcer has undertaken to see through the huge volume of reforms already on the books. Being frugal with the new rules helps him to be adamant about the old.

The idea is that for Europe's 450m people the commission's latest ideas, though few, should be more visible than all the 41 initiatives on financial services that have come through the pipeline in the past five years. Hitherto, the commission has focused on harmonising wholesale financial services, such as inter-bank payment systems, and on areas in which benefits could be won fairly quickly, such as government-bond and equity markets. More has been done in commercial banking (notably on capital-adequacy requirements) and accounting (with moves towards common standards) than in, say, insurance or consumer credit. In other words, little has been done that directly affects the bank accounts, mortgages and insurance policies of ordinary

Europeans.

To rectify this, the new plan pays more attention to retail financial services. For instance, the commission wants to make it easier for people to open and close bank accounts across borders, and to transfer money between accounts in different countries without hitting big obstacles or incurring high fees. The White Paper also calls for plans to harmonise asset management, credit intermediaries and banking supervision, among other things—but the details will not be fixed until industry weighs in. Efforts to align mortgage products and to reduce the costs of cross-border payment are proceeding separately.

The commission admits that differences in language, culture and regulation across the EU's 25 member states will make it relatively hard and costly to harmonise retail financial services. Even so, Mr McCreevy contends that the common man must see the benefit of what he calls “Europe”. “The only way you get the message across to the public of Europe is to keep it simple,” says a member of his staff. “We need a single pan-European market.”

Whether consumers will take advantage of new choices in financial services is uncertain. John Tattersall, a partner at PricewaterhouseCoopers, notes that they still show a lot of inertia, even when they have options. “In some ways it's blind loyalty,” he says. “Even if they're not getting great service, they'll stick with their Spanish or French bank, or their German insurer.” But as more Europeans own property or work abroad, the idea of similar, pan-European financial services may gain appeal. A Eurobarometer poll last year found big increases in the numbers who say they would like to use cross-border bank accounts, credit cards, car insurance and mortgages within five years.

Here's some we prepared earlier

Part of the reason for the White Paper's slenderness is that the commissioner's staff want better regulation, not more. This is a response to criticism from the financial industry about the quality and quantity of legislation that has emanated from Brussels. “The corporate sector is beginning to whinge” about the costs of implementing measures already passed, says Graham Bishop, a consultant on European regulation. “But their bosses have been demanding this for years and years. We're into the phase of implementation where whingeing is to be expected.”

There is already plenty to do. Many regulations have been passing through the EU pipeline, from the commission to ministers, the European Parliament and national governments and legislatures. This week Britain's financial regulator, the Financial Services Authority (FSA), said that the industry should start preparing for a particularly weighty regulation, the Markets in Financial Instruments Directive (MiFID). More detailed guidelines are due from the commission next month. Although the deadline for firms to comply has been pushed back to 2007, the FSA thinks they need to act now.

“This is probably the biggest piece of financial-services legislation ever passed in the world,” says Bob Fuller, head of information technology at Dresdner Kleinwort Wasserstein, an investment bank, who co-chairs a working group on the directive. “Its aim is to completely reshape the financial markets in Europe.” He worries that even a 2007 deadline is too soon, given other demands on financial firms.

MiFID's objectives—increased transparency and reduced costs for users of financial instruments such as equities, bonds and derivatives—will be pursued through standardised rules on the dissemination of quotes and on pre- and post-trade transparency, as well as vaguely defined “best execution” practices. Implementing the directive could require large amounts of new information technology and cost the financial industry plenty. Consultants have reckoned the bill for the

average European investment firm to be €20m-30m ($24m-35m). Another estimate puts the cost of technology implementation in Britain alone at £1.5 billion ($2.6 billion).

Jean-René Giraud, of Edhec Risk, a research firm, says that complaints about cost are mere scaremongering. In his view, consumers have the most to gain. He also predicts that dealings in financial instruments will be increasingly concentrated in the hands of global investment banks, which should gain from the regulation. Losers are likely to include small financial firms, and possibly exchanges, if they do not react fast.

How much more regulation there will be, and when, depends in large part on how quickly national governments convert EU directives into national law. So far the pace has been uneven. When states drag their heels, the enforcer steps forward. In a speech last week, Mr McCreevy sounded resolute. “When times are tough there is a perhaps understandable, though entirely misguided, temptation to throw up protectionist barriers in the hope of short-term, quick-fix gains,” he said. “I will fight this tendency tooth and nail.”

The commission has begun an investigation of potential obstruction of cross-border mergers in Italy, for instance, and still could start proceedings against the government there over its handling of foreign bids for Italian banks. The recent successful bid by the Netherlands' ABN Amro for Antonveneta suggests that Mr McCreevy is being heard.

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Economist.com FINANCE & ECONOMICS

Leaving the euro zone

Exit fee

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The credit-rating consequences of quitting the single currency

WILL all the 12 countries in Europe's single currency remain members in three or four decades? The question may seem imponderable. But euro-area governments floating 30- or even 50-year bonds are asking investors to ponder it nonetheless. Anyone lucky enough to hold one of Italy's 30-year sovereign bonds, for example, might want to consider how likely Italy is to repay them, should it ever quit the single currency—as some in today's governing coalition might like. As a service to the forward-thinking, Standard & Poor's (S&P), a rating agency, has offered a speculative answer.

The repercussions of exit would depend on the reasons for leaving. S&P assumes that countries such as Italy and Greece would want to regain their own currency only to debauch it. Both have lost competitiveness since the 1990s. Italy's unit labour costs are projected to be 27% higher by the end of 2006; Greek costs have increased by almost half. In S&P's simulations, the Italian government announces a surprise exit from the euro on the last day of 2006, and promptly devalues the new lira by 27%. The Greeks devalue by 49%.

Both countries would thus recoup, at a stroke, the competitiveness they have lost. Unfortunately, their debts would still be payable in euros. Italy's public debt would jump, at a stroke, from 108% of GDP to 138%; Greece's from 107% to 161%. Neither government would service these debts without strain: Italy's credit rating would drop from AA- to A-. Greece's would drop from A to BBB-, only just investment grade.

Why couldn't euro refugees simply redenominate their debts in the new lira or drachma? After all, they had to convert their debt into euros when they joined the currency club. The difference, as S&P point out, is that the lira and drachma then ceased to be, and the euro was their legal successor. If the Italians or Greeks left, the euro would still exist, and their creditors would still expect to be repaid in it. Redenomination would count as repudiation.

Leaving the single currency would cause the coinage of some ugly new words: lirafication, or worse, drachmisation. The economic consequences would not be pretty either.

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Economist.com FINANCE & ECONOMICS

Reinsurance

Top of the pile

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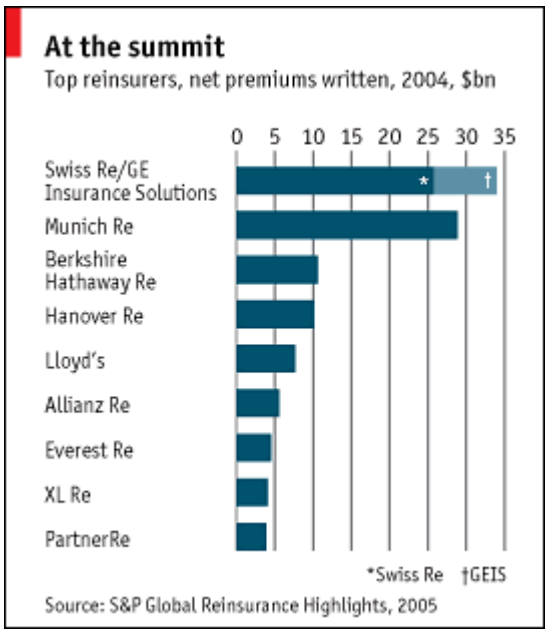
Swiss Re strives to become the world's biggest reinsurer

FOR 20 years Swiss Re, the world's second-biggest reinsurer, has been trying to topple Munich Re from the number-one spot. With the planned $6.8 billion takeover, announced last week, of most of the insurance activities of America's General Electric, Swiss Re will be top dog at last.



However, sheer scale is unlikely to be the main reason for Swiss Re's purchase. Reinsurance—the business of covering primary insurers' risks—requires a certain size to take on the financial costs of natural catastrophes, terrorist attacks and so forth, as well as permitting diversification across regions and business lines. But the top five reinsurers are well past that threshold. The best argument for Swiss Re's acquisition is the opportunities it might bring in the American market.

Has it bought well? GE wanted to quit insurance at almost any cost, to focus on industries with more growth and less trouble. Its insurance arm, General Electric Insurance Solutions (GEIS), has a poor underwriting record and a history of claims for asbestos-related illness. GE accepted a lowish price, in cash and shares, for GEIS. And having already injected $7.7 billion into its subsidiary's reserves between 2000 and 2004, it will add $3.4 billion to reserves to seal the deal. Jacques Aigrain, Swiss Re's deputy CEO, who is due to become chief executive in January, says he is confident that his new addition now has enough reserves.

The difficulties may not end with a topping-up of reserves. Buying GEIS will increase Swiss Re's already significant presence in the American casualty-insurance market. It can therefore expect some clients who deal with both companies to shift business elsewhere, to spread their risks. Mr Aigrain says he expects to lose perhaps 30% of the new company's business. He also wants GEIS to be choosier in its underwriting. Awkwardly, however, the contract-renewal season occurs in January—and the deal, giving Swiss Re control, will not be closed for several months after that. Top rating agencies have taken a dim view of the purchase.

The deal comes at the end of two rough years for reinsurers, rounded off by this year's hurricanes, from which the pre-tax insured losses could reach $80 billion in America alone. Reinsurers will have to pay a good slice of the bill, and analysts estimate that this could wipe out a quarter of the industry's capital base. Is there a bright side? Yes, because hard times are often the moment for expansion. As reinsurers repair their balance sheets, prices will increase next year and probably the year after too. Demand is rising in America, which accounts for half the world's reinsurance

market.

Swiss Re's experience with takeovers has generally been happy. In 1996 it grew by a third when it bought America's Mercantile & General Re. It added three more American companies in the following five years. Munich Re, in contrast, has struggled with American Re, which it acquired in 1996. Profits fell steeply in the first half of this year, because it had to fill holes in American Re's reserves, mainly caused by asbestos and environmental costs.

Munich Re concedes that American Re is causing a headache. It says that it won't follow Swiss Re with a big acquisition, and adds that it is more interested in profits than volume. The difference that the GEIS deal truly points up, however, is the two giants' attitude to specialisation. Munich Re is more diversified, with a big interest in primary insurance, which tends to be more stable than reinsurance. Swiss Re is focused on reinsurance. Its purchase shows it is more convinced than ever that it is right.

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Economist.com FINANCE & ECONOMICS

Banking in the Middle East

Oil rush

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Western banks' big ambitions

THE rise in the price of oil has created a glut of wealth in the Middle East that makes foreign bankers' eyes spin. HSBC, one of the world's biggest banks, has launched three new ventures in the region in the past two months and its rivals are likely to unveil others in an attempt to tap into Middle Eastern riches.

HSBC's newest joint-venture, an investment bank in Saudi Arabia, should be operational by the end of the year, offering everything from initial public offerings to private banking. It is applying the same strategy in its Kuwaiti branch, which opened on October 2nd. The Gulf state decided last year to end a 34-year ban on foreign banks.

However, HSBC's boldest move is its purchase of a 70.1% stake in Iraq's Dar Es Salaam Investment Bank on October 28th for an undisclosed sum. Perhaps not surprisingly, HSBC cannot yet outline its strategy in Iraq, despite negotiating for six months to establish its joint-venture. Details on Dar Es Salaam are scant, but by international standards it is tiny, with 14 branches and assets in the tens of millions of dollars.

Banking in Kuwait is not easy either. BNP Paribas, the first foreign bank to open a branch there, was granted a licence in August last year. It still struggles for recognition among locals; sometimes even government officials refuse to accept it as a signatory.

Licence conditions demand that foreign banks have minimum capital of 15m Kuwaiti dinars (roughly $50m) and that within three years half their employees are Kuwaitis. However, new entrants believe their brands will attract locals active in global business and that their economies of scale will let them accept finer margins than the six domestic banks—a strategy successfully employed elsewhere in the Gulf.

Saudi Arabia has the potential to be the most lucrative Middle Eastern market for foreign banks. It has the region's biggest stockmarket, and the benchmark Tadawul All-Share Index has nearly doubled this year. HSBC's joint-venture with The Saudi British Bank, HSBC Saudi Arabia, will aim to profit, in particular, from a boom in initial public offerings. It is also eyeing potential privatisations and the developing domestic bond market. Foreigners cannot invest directly in the Saudi Arabian stockmarket, so most of the money raised will come from locals.

However, for all the fanfare, these are still emerging markets. Many of the businesses that will be targeted by foreign banks are family-owned and local stockmarkets are concentrated. The top 20 stocks in Saudi Arabia, for instance, account for two-thirds of the market's capitalisation. Middle Eastern ventures, despite the region's vast wealth, are not for the faint-hearted.

Economist.com FINANCE & ECONOMICS

Innovative securities

Chameleon bonds

Nov 24th 2005 | NEW YORK
From The Economist print edition

Wall Street's next big thing

CORPORATE finance is like being caught between the hammer and the anvil. Because interest payments are tax-deductible, debt is appealing—but then it has to be repaid even when times are hard. Equity does not have to be paid back—but because dividends are paid after taxes and equity offers investors less protection than debt, it costs companies more.

The ideal security would be the best of both, looking like equity to credit-rating agencies and debt to the taxman. This is precisely what Lehman Brothers achieved in America in August, when it issued a $300m security named an ECAPS, for Enhanced Capital Advantaged Preferred Security, after six months' work by its tax experts. Other banks are following. On November 22nd Citigroup closed on the first issue of this type for a corporation, a $450m ETRUPS (Enhanced Trust Preferred Security) on behalf of Stanley Works, a Connecticut toolmaker.

After Thanksgiving, Lehman is expected to unveil a number of deals. Citigroup and Deutsche Bank will be in the business too. One banker likens the current work on the new securities to an arms race, in which all sides attempt to tweak their products in ever-cleverer ways.

The securities will, however, share important features. Like debt, they carry routine payments and have finite (but long) maturities, 60 years for Lehman's offering and 40 for Stanley's. This matters because guidance from the Internal Revenue Service suggests that debt securities must have a redemption date.

At the same time, like dividends on shares, the interest payments can be deferred in times of financial stress. They can also be met by issuing extra shares at maturity. This pleases rating agencies, since it spares the company some strife when money is tight. Moody's agreed to treat the Stanley security as if it were half equity, and the Lehman deal as 75% equity.

The general idea may remind some in Europe of the *Genussscheine*, or participation certificates, issued by German companies. Some *Genussscheine* are like bonds, with a regular coupon that can be delayed in hard times. Others are closer to equity, with dividend-like payments that can be cancelled under specified conditions.

Investors have welcomed the innovation. Stanley's hybrid trades at just three-quarters of a percentage point above its conventional bonds, which offer investors far more protection in the event of bankruptcy; Lehman's yields half a point extra.

Given all this, you might ask why firms would ever issue anything else. Liquidity may be one problem. Though substantial, the issues so far have been registered as private placements. A more remote risk is that Congress will one day remove the differential tax treatment of debt and equity.

Interest was exempted from tax, because it was considered a cost of business; dividends were not, because they were considered a distribution of profit. In fact, both are a cost—specifically, of capital. There is a strong argument for taxing the two at the same rate, if only it were politically feasible. Exempting dividends, especially, would be seen as a gift to the rich. Leaving the rules as they stand, however, is a gift to Wall Street's cleverest.

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Economist.com FINANCE & ECONOMICS

Reforming Taiwan's banks

Folly by numbers

Nov 24th 2005 | TAIPEI
From The Economist print edition

The government of Taiwan is getting too much in the way

TAIWAN has much in abundance: soaring mountains, sulphurous hot springs, delicious food—and banks. A stroll in the streets of Taipei reveals a kaleidoscope of logos: Taishin's red, E.Sun's green, Taiwan Business Bank's orange. The capital has 850 branches, or 3.4 for every 10,000 people—almost three times as many as New York and two-thirds more than it needs, reckons McKinsey, a consultancy.

In all, the island nation of 23m people has about 45 commercial banks, 14 financial holding companies (FHCs, which own at least one bank plus insurance and broking subsidiaries) and over 300 rural credit co-operatives. Most are tiny. The top five lenders have just 35% of the market, versus 60-80% in most developed countries.

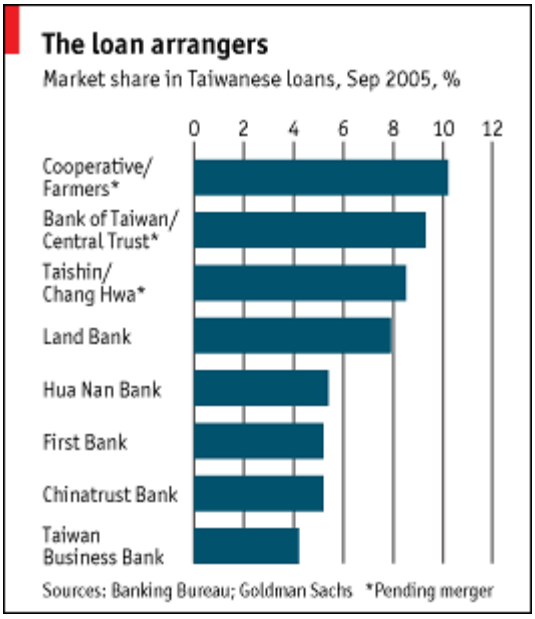
A lack of scale and fierce competition have left revenues flat and profits anaemic. In the first half of 2005 the banks' average return on equity was around 8%, the lowest in Asia, says Fitch, a rating agency. The government's involvement has stifled efficiency and innovation. In effect, it controls a dozen banks, including the six largest.

With Taiwan losing manufacturing jobs to China, its economy needs services. It especially needs banks that are good and big enough to serve Taiwanese businesses overseas—although China, these customers' main destination, remains off-limits. Kong Jaw-sheng, chairman of the Financial Supervisory Commission, the financial-industry regulator, warns: “Taiwan's banks cannot shut the door on the island. They must go out and serve clients or they will become like Japan's.” Yet the industry is in no shape to compete globally or to form the Greater China financial hub of the government's dreams.

In the past five years the number of banks has barely fallen, from 53 (although two mergers have been announced this month). In October 2004 Taiwan's president, Chen Shui-bian, sought to speed reform by outlining an ambitious agenda to cut the number of state banks by half to six by the end of this year; to see a bank in foreign hands by the same date; eventually to create at least three institutions with market shares of 10%; and to halve the number of FHCs to seven by the end of 2006.

A year on, this initiative is floundering. One reason is the government's insistence on controlling every aspect of consolidation. It cleaves to its numerical targets, leading it to force through bad mergers. To bring mergers about, it has banned new branch openings and demanded the cull of FHCs even though most are private and healthy. Christina Liu, an opposition legislator and a finance professor at National Taiwan University, complains: “Bank reform is a disaster. The market should decide the number and timing of deals. But this is the plan of a

controlled economy."



But the government is not in control. It failed to persuade the public and the bank unions of the need for reform. Its policies were hatched without consulting the legislature (which must approve the sale of state assets), local bank bosses or even the regulator. This might not have mattered had the government been politically strong. But it has a slim majority and is weak. Backed by the opposition and the media, the unions have turned bank reform into a controversy ahead of local elections on December 3rd. They have taken to the streets to oppose takeovers by private banks (and to protect state-bank workers' cushy jobs).

The government has caved in. After huge protests in September, the Ministry of Finance halted the takeover of ailing, state-owned Taiwan Business Bank by E.Sun, a profitable FHC, despite generous terms including compensation, worth six years' pay, for "retiring" workers. Mr Kong, the regulator, says he cannot fathom that decision. The unions are now threatening the merger of Chang Hwa Bank, the sickest state lender, and Taishin, a strong private group that stepped in to rescue Chang Hwa this summer, after the government bungled a sale to foreign bidders. The unions complain that private conglomerates are pillaging state assets—Taishin belongs to the Wu family, one of three powerful clans that own several FHCs. The government structured the deal to favour Taishin and itself, penalising minority shareholders and fuelling the resentment.

Under union pressure, the government has also failed to support reformers. In April it removed the chairman of First FHC, Steve Shieh—ostensibly because he said "bullshit" in a televised government meeting. A colleague at First says workers "hated" him for making changes, although he turned the bank into the only state lender private groups want to buy. Fubon, an FHC, is interested, as is Temasek, Singapore's state investment agency.

The fixation with numerical targets—such as the one governing six state banks—has led to a string of bad decisions. Taiwan Business Bank's failed sale left one state lender too many, so the government simply halted a planned overseas listing by Land Bank, the second-biggest, to mull a three-way merger with Bank of Taiwan (BoT), the biggest, and Central Trust. On November 18th the government finally decided to fuse only BoT and Central Trust. Insiders at Land say the uncertainty was "hugely damaging" and prompted "hundreds" of staff to leave. BoT's new boss, whose powers are so limited that the bank cannot even award performance bonuses, now faces a distracting integration. Unhappy, too, is the arranged marriage of Farmers Bank to Cooperative Bank, announced on November 8th, to create Taiwan's biggest lender. The head of Cooperative is known to have said privately that he sees no synergies with Farmers. Victor Kung, finance director of Fubon, says that mergers of state banks "delay reform. Bigger state banks are harder to buy."

Private banks are in a bind. Tension across the Taiwan Strait is blocking direct access to China. To grow at home, they must merge, but unions make state lenders a risky buy. Although Fubon bought Taipei Bank in 2002, the two were integrated only this year and returns remain below pre-merger levels. Yet private lenders are also unwilling to team up with each other. When the 14 FHC chairmen were asked at a recent parliamentary meeting who was planning to buy a rival, 11 raised their hands. Asked who was willing to be taken over, none did. Not surprisingly, Fubon is looking outside Taiwan for growth: it wants to take a stake in a small Chinese bank, through its Hong Kong subsidiary.

Meanwhile, high prices will deter foreigners who would otherwise like to buy Taiwanese banks. Fearing accusations of selling state assets cheaply, the government is overpricing its shares. In March that ruined the sale of around 40% of Chang Hwa to foreigners, driving away bidders including ING, a Dutch bank, and Japan's Shinsei. Others are cutting local branches, citing low returns.

To reform Taiwan's banks successfully, the government will have to drop its numerical targets, privatise more (preferably via open auctions) and remove market-distorting measures, such as the ban on organic growth. It should also make the regulator fully independent and explain the need for reform to a sceptical public. All this is politically risky. But it may also be economically necessary.

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Economist.com FINANCE & ECONOMICS

Thailand's stockmarket

Fermenting trouble

Nov 24th 2005 | BANGKOK
From The Economist print edition

The unsettling effect of shelving two share offerings

EPA

The government begs to differ

DRIVING past the Stock Exchange of Thailand, you never know what you might see. A few months ago, orange-robed Buddhist monks were protesting against the planned listing of Thai Beverages, the country's biggest brewer and distiller. More recently, left-wing activists marched against the partial privatisation, through a public offering, of Egat, the state-owned electricity monopoly. Indeed, these days, demonstrators seem more interested in Thai stocks than investors are.

In 2003 Thai stocks were among the world's top performers. The main market index more than doubled, as the economy grew by 6.9% and finally shook off the torpor that had set in after the crash of 1997. Alas, Thailand has since suffered a string of misfortunes: bird flu, last year's tsunami, a prolonged drought and an intensifying insurgency in some Muslim areas. Meanwhile, dearer oil has pushed inflation up, prompting the central bank to raise interest rates repeatedly. Expensive oil imports have also weighed on the current account, and so on the baht.

In the first quarter of this year, the economy even shrank slightly. Over the whole year, it might grow by some 4%, far less than optimists had expected. In August consumer confidence hit its lowest in three years. All this gloom has affected share prices too. The market looks like ending the year where it began, 15% below the peak it reached early last year.

The protests have not helped. The listing of Thai Beverages, originally scheduled for the middle of the year, would have been the biggest-ever flotation of a private Thai firm, worth roughly 40 billion baht ($980m). But the World Health Organisation ranks Thais as the world's fourth-keenest drinkers, and temperance groups, supported by Buddhist clergy, argued that the listing would foster further boozing. The stock exchange and its regulator have not yet dared approve it.

The government's attempt to sell a stake in Egat has dragged on even longer. It first postponed the offering last year, after protests by the company's staff. As a sweetener, it raised workers' salaries and reserved shares for them, before reviving the sale earlier this year. It had planned to sell 25% of Egat this month, for 33 billion baht or so. But at the last minute, a court put the listing off again, to consider activists' charge that the decree authorising the sale violates the constitution. The government still hopes that the sale, and the rest of its privatisation programme, will go ahead—but the court has not even set a date for a ruling.

On the other hand, Thai stocks now look cheap next to other markets in the region, or at any rate cheaper than they did. The average price/earnings ratio, which topped 14 in 2003, is now around nine, and falling. If, as economists expect, the recent easing of the oil price continues next year,

and interest rates also decline, the market should start to recover. And the resuscitation of the shelved listings might give traders cause to celebrate—soberly, of course.

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Economist.com FINANCE & ECONOMICS

Economics focus

Marking the dealer's cards

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What economists can learn from currency traders

YOU can make a career as an exchange-rate economist without ever crossing paths with a currency trader. The dealers who set the dollar's price and the professors who theorise about it are separate breeds, speaking different tongues and operating at quite different metabolic rates. This is how Richard Lyons, an economist at the Haas School of Business (part of the University of California, Berkeley), describes a day spent with a friend of trading stock*.

> Most of the time my friend was reading tea leaves that were, at least to me, not so clear. The pace was furious—a quote every five or ten seconds, a trade every minute or two...He looked over in the midst of his fury and asked me, “What should I do?” I laughed. Nervously.

If asked that question at the start of the year, most economists, watching the steady deterioration of America's current-account balance, would have told a dollar trader to sell. That would have been costly. The greenback reached two-year highs against the euro and the pound this month—before slipping back a bit after the president of the European Central Bank indicated that higher euro-zone interest rates were on the way.

The currency market routinely confounds economists. A classic 1983 study by Richard Meese and Kenneth Rogoff, then both at the Federal Reserve, concluded that macroeconomic models could not explain a currency's direction of travel, let alone how far it would go. One would do just as well to assume that next month's exchange rate will be the same as this month's. After another 20 years of interrogation, the macroeconomic data has confessed little more of value. A new review of the evidence† finds that some models, in some periods, beat tossing a coin. But not by very much.

Testing the tea leaves

If traders can learn nothing from economists, can economists learn anything from traders? No, is the customary answer. Economists traditionally assume that everything worth knowing about a currency is known by everyone; and that anything new is quickly embodied in the price. They imagine the market governed by an auctioneer, who finds the price that will square everybody's bids and offers before any actual trading takes place. Economists study the auctioneer, not the traders.

After his visit to the trading desks, however, Mr Lyons decided that dealers merited closer examination. He and Martin Evans, of Georgetown University, are part of a wider effort to model the currency market from “the trenches”††. We cannot understand how currencies behave, they argue, unless we study the thinking and behaviour of those who trade them.

The mythical auctioneer is notably absent from the models they construct. In his place stand the big currency dealers, who act as marketmakers, willing to buy or sell any amount of currency at their quoted prices. The marketmaker will take orders from a mix of clients—from American multinationals repatriating profits, to Asian central banks manipulating their currency—whose beliefs are as diverse as their motives.

These orders represent opinions, backed by money. As such, they convey useful information about what clients believe and how strongly they believe it. The marketmaker is privy to all of these opinions as they accumulate on its order books, while its clients know only their own. It is like a poker game in which only the dealer is allowed to see what each player throws into the pot.

What can be learned from peering over the dealer's shoulder? Messrs Lyons and Evans have access to six and a half years of data, ending in June 1999, from Citibank, one of the largest dollar dealers. The figures show the balance of orders flowing into the bank: on any given day, customers may buy more dollars from Citibank than they have sold to it, for example. This positive “order flow”, as it is called, is valuable evidence of buying pressure that is visible only to the dealer.

Any such pressure will eventually be reflected in a stronger currency. What is surprising is how long it takes. Given that a trade is made every few minutes, a quotation every few seconds, one would think that any information in today's order flow would be swiftly incorporated into the dealer's quotes and the dollar's price. Whatever forecasting power the flow of orders possesses, it should be quickly exhausted.

It turns out, however, that the information in today's order flow will still be percolating through the market weeks afterwards. It takes time for a marketmaker to make sense of his orders, to distinguish signal from noise, plot from happenstance. It takes more time still for that insight to spread to the market as a whole, as dealers reveal what they know through their quotes and trades with each other. This hiatus creates an opportunity for forecasters. Messrs Lyons and Evans reckon that Citibank's order flow can predict almost 16% of the dollar's bobbing and weaving four weeks hence. That may not sound like a lot. But the macroeconomists cannot even explain what is going on today, let alone 16% of what will happen a month from now.

The two economists invoke Friedrich Hayek, who long ago pointed out that the economy runs on “dispersed bits of incomplete and frequently contradictory knowledge”. These scattered insights, Hayek stressed, are communicated to everyone through shifts in market prices. But with the dollar, a big dealer's order books provide a sneak preview. If you can look into those books, you can infer something useful about the dollar next month. If not, then, like the rest of us, you can just flip a coin.

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* “The Microstructure Approach to Exchange Rates”. MIT Press, 2001.

† “Empirical Exchange Rate Models of the Nineties: Are Any Fit to Survive?”, by Y.-W. Cheung, M. Chinn and A. Garcia Pascual. *Journal of International Money and Finance*.

†† Many of their papers can be found at www.georgetown.edu/faculty/evansm1.

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AIDS

Spin doctors

Nov 24th 2005
From The Economist print edition

Getty Images

The much-trumpeted 3x5 Initiative to treat poor AIDS patients seems to have been airbrushed from history

Get article background

FROM the beginning, AIDS has been a politically charged disease. It has pitted rich against poor, and puritans against the politically correct. For the most part, though, the different opinions of these diverse lobbies have been honestly held and vigorously defended. In that context, the release of this year's “AIDS epidemic update”, the annual report on the disease by UNAIDS and the World Health Organisation (WHO), may give the reader a slightly uneasy feeling. For, alongside the awful, inexorable figures—the number of people infected is now more than 40m, and more than 3m died last year alone—something has inexplicably vanished.

In 2003, the two agencies launched what was known as the 3x5 Initiative. This had the aim, by the end of 2005, of getting 3m people in poor and middle-income countries on to the antiviral drugs that sufferers in rich countries have come to regard as their birthright. It is hard, however, to find any mention of it in this year's report.

Presumably, that is because reality is going to fall woefully short of ambition. Though the final figures are not out, as the deadline has not yet passed, the last progress report talked of 1m rather than 3m.

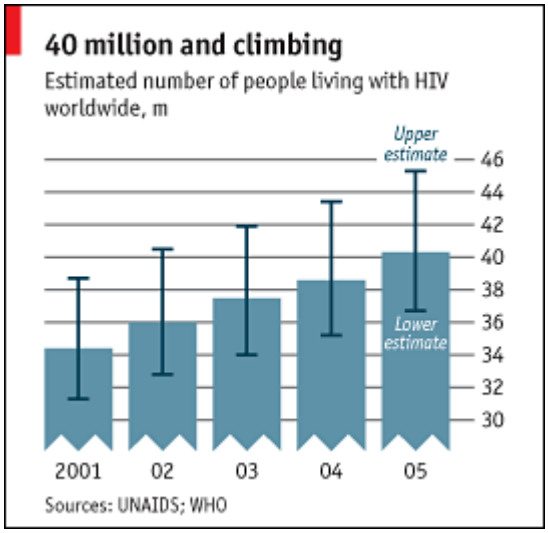
Since then, things have gone rather quiet. And that is a pity, for there is enough genuine uncertainty surrounding AIDS, without manufacturing more. In retrospect, the target of 3m was

far too ambitious. Even having 1m people on the drugs has achieved a lot. As the report puts it in a paragraph that studiously avoids the term “3x5”, “because of the recent treatment scale-up since the end of 2003, between 250,000 and 350,000 deaths were averted in 2005.” That is genuinely good news.

Reality check

The reason for worrying about all this is not that the target was missed, but that the feasibility of reaching it was based on a set of over optimistic modelling assumptions about such things as the effectiveness of drug distribution networks and the competence of local health services. Both the models and the reality on the ground have changed in the light of experience, of course. But a more open acknowledgment of past errors would give greater confidence that future targets might be hit. The G8 group of industrialised countries recently suggested that antiviral drugs should be available to all who need them by 2010, a target that has been enthusiastically embraced. It would be a pity if poor planning meant that objective were missed, too.

There was also some confusion around what looks, at first sight, like a piece of rare good news—that four countries previously regarded as AIDS basket-cases, namely Burkino Faso, Haiti, Kenya and Zimbabwe—had seen a fall in the prevalence of infection with HIV, the virus that causes the disease. Dig into the detail, though, and a good part of this decline seems to be the result of the infected dying, and thus no longer appearing in the statistics. How much is due to the rate of new infections falling is very hard to ascertain.



Certainly, as the report acknowledges, 80% of the decline in prevalence in a heavily studied part of Uganda was caused by such a die-off—and Uganda has, in the past, been trumpeted as the first, best example of a country that has got its epidemic under control. Sadly, not quite such a triumph as might at first appear.

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Economist.com SCIENCE & TECHNOLOGY

Neurogenetics

Fear not

Nov 24th 2005
From The Economist print edition

Mice lacking a particular gene are fearless

FEAR helps animals, including humans, to survive since it allows them to avoid predators and dangerous situations. Having too much fear, or not being able to control it, can, however, harm them. It can freeze animals into inaction, which is hardly an effective defence tactic, and it can cause a variety of debilitating disorders, such as phobias, pathological anxiety and the increasingly fashionable diagnosis of post-traumatic stress disorder.

Understanding how fear is formed in the brain may shed light on these disorders and help to develop ways to erase unwanted fears. In a paper published in the current issue of *Cell*, Gleb Shumyatsky, of Rutgers University in New Jersey, and his colleagues have achieved just that, in mice at least.

Dr Shumyatsky was interested in the role of a gene called stathmin. His interest was piqued because this gene, though present in every cell in the body (as are all genes), is active only in cells of a part of the brain called the amygdala. It was established a few years ago that the amygdala is the area that governs fear. Rare individuals whose amygdalas (of which there are two, one in each cerebral hemisphere) are damaged are, literally, fearless.

To investigate the role of stathmin, Dr Shumyatsky and his team established a strain of so-called knock-out mice who had had the gene removed from their DNA. They then conducted a series of experiments on instinctive and learned fear.

The team found that their knock-out mice showed neither form of fear. They would, for example, venture insouciantly into environments that normal mice avoid, such as open spaces and elevated platforms where they could easily be seen by predators. They were also less prone to freeze up in response to events that would normally induce fear, such as seeing cats.

In addition to this lack of instinctive fear, the knock-out mice seemed to have weaker memories for past aversive experiences. The researchers tested this using the famous experimental method called conditioning, which was developed by Ivan Pavlov over a century ago. The essence of conditioning is the pairing of two stimuli: a neutral one such as a sound (Pavlov famously used a ringing bell) and a significant one, such as an electric shock, that produces a strong and consistent response. If an animal is given the shock immediately after hearing the sound, it will associate the latter with the former and show fearful behaviour when it hears the sound.

Using this sort of set-up, Dr Shumyatsky discovered that mice with stathmin knocked out found it hard to make the association. They could not, in other words, learn to be afraid. To be sure this was not due to changes in other features that might result from lack of the gene, he tested the animals' hearing and pain sensitivity. Both were normal. So was their spatial memory. And although he did not try tests where the learned association was with a pleasant rather than a fearful stimulus, he is reasonably confident that stathmin's effect is specific to fear because it is confined to the amygdala.

The researchers also have an idea about how the effect happens. Stathmin's role is to control the assembly and breakdown of structures called microtubules. These tubules act as a cell's internal skeleton. Memory formation requires the establishment of new connections between nerve cells, part of a process known as long-term potentiation. Forming those connections requires the assembly and disassembly of microtubules. Given that stathmin is active only in the amygdala, and that there was, indeed, a reduction in the amount of long-term potentiation in the relevant nerve pathways, Dr Shumyatsky draws the obvious conclusion that stathmin's role might explain why mice lacking it are fearless.

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Economist.com SCIENCE & TECHNOLOGY

Space

The falcon's prey

Nov 24th 2005
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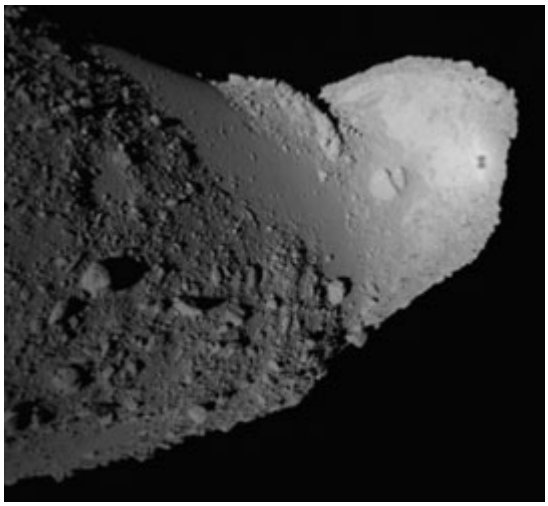
A Japanese mission to return an asteroid sample to Earth hits problems

AP



See any rabbits down there?

ITS target is ambitious: to be the first spacecraft to land on an asteroid, collect samples and return them to Earth. But the Japan Aerospace Exploration Agency's *Hayabusa* mission is experiencing a bumpy flight. A couple of weeks ago, the spacecraft, whose name translates as "*Falcon*", released its tiny lander at the wrong time, sending it floating off into eternity instead of hopping about on asteroid Itokawa—which, not coincidentally, is named after Hideo Itokawa, the founder of Japan's space programme. Then, on November 20th, the probe itself managed to land briefly, but failed to deploy a second package of rock-collection equipment. It is expected to make a further attempt to swoop down on its prey in the next few days.

Researchers want samples from asteroids in order to learn more about the early solar system. Asteroids are remnants of the disc of dust and gas from which the planets formed 4.6 billion years ago. Their chemical compositions are thought, in many cases, to have remained unchanged by geological processes of the sort that shaped the Earth and the other inner planets. Some, however, are pieces of larger, geologically active bodies that have been shattered by collisions. In this case the inner workings of such bodies, which were, in effect, small planets, are exposed to scrutiny in a way that is impossible with existing small planets.

Most of the hundreds of thousands of asteroids within the solar system appear to have surfaces composed of carbon, silica or various metals—that much can be worked out by looking at the spectrum of the sunlight they reflect. But actual samples would provide a lot more detail. They might also prove valuable if it was ever necessary to divert the orbit of an asteroid that threatened to collide with the Earth.

Hayabusa's main objectives, though, are technical. It is the first interplanetary mission to use an ion engine as its main propulsion device. An ion engine is a rocket that is propelled by ionised (ie, electrically charged) gas that has been accelerated by electricity within the motor. Such a system is more efficient than a traditional chemical rocket, which is propelled by gas generated from a reaction between a fuel and an oxidant. *Hayabusa* thus requires only a tenth of the fuel of a traditional thrust engine, making it much lighter, and therefore easier to launch from Earth.

Hayabusa, which is running on autopilot, because radio signals from Earth take 17 minutes to arrive, has until early December to complete its business at the asteroid before embarking on the trip back home. It should return to Earth in June 2007, preferably with its cargo.

Economist.com SCIENCE & TECHNOLOGY

Snowmaking

All-weather wonderland

Nov 24th 2005
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American ski resorts are making snow more efficiently, cheaply and quietly

COMING from one of Vermont's largest ski areas, it is an odd-sounding boast. This winter, Stowe Mountain Resort claims to be the “only ski area in New England to have a fully automated snowmaking system on one of its mountains.” A party to celebrate the arrival of the snow guns and other new equipment is scheduled for December 17th.

Surprisingly, only about 15% of America's ski resorts have the sort of automated snowmaking equipment that would allow them to open earlier in the autumn and close later in the spring. That compares with 98% of resorts in Europe, according to Geir Vik, the head of North American operations at TechnoAlpin, the world's largest snowmaking company. But this could change as the equipment itself changes.

The basic process of making snow is straightforward. The ingredients are compressed air and water. These are piped to the mountainside and combined in a snow gun that is powered by electricity. The water droplets ejected by the gun expand in the atmosphere because it is at lower pressure than the air used to make the droplets. That expansion, as every high-school physicist will surely remember, causes the droplets to cool. They thus crystallise and fall to the ground.

To cover a slope with enough snow to ski on, guns must be stationed about 15-30 metres apart, so hundreds are needed at the average resort. That is expensive, as is the compressed air required to feed the guns. The power bills at big resorts can be several hundred thousand dollars a month, according to Mr Vik.

It is no surprise, therefore, that snowmaking in America is changing as energy prices rise. Airless “fan guns” are much in demand. These atomise water with a stream of air, using tiny nozzles arrayed around a huge fan blade. They also launch the droplets further above the ground—and the higher the trajectory, the more time a droplet has to freeze before it lands. Add in a bacteria-derived protein called Snomax, which acts as a “nucleation centre” for droplets, encouraging them to freeze quickly at temperatures as much as 6°C higher than they would without nucleation, and the result, according to Rich Brown of York Snow, which makes Snomax, is a gun that uses water and compressed air in equal quantities. In 1990 an equivalent gun would have used 15 times as much compressed air as water, and thus been far more expensive to run.

Now, though, resorts are embracing automation, an even bolder change. At the moment, each snow gun must be programmed individually. That means men spending long hours trekking around the mountain every night setting the guns according to the temperature, humidity and wind conditions. If any of these factors change in the middle of the night, the new snow will be useless.

With automation, according to Mr Brown, “everything can be done with the click of a mouse.” Weather stations around the mountain measure the conditions and feed the results into a database that sets the guns. So one man, sitting in a comfortably heated office, can run hundreds

of guns.

The result, according to Mr Vik, is about 25% more snow per gun. And there is another advantage to the new technology: it is quieter. At some ski resorts, the older guns could be heard in expensive chalets 3km away. As Mr Vik wryly observes, “you just can't have a noisy ski system outside a home worth $15m.”

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The roots of democracy

People power

Nov 24th 2005
From The Economist print edition

Two academics use game theory to explain why democracy is so hard to achieve

Economic Origins of Dictatorship and Democracy
By Daron Acemoglu and James A. Robinson

Cambridge University Press; 540 pages; $35 and £25

Buy it at
Amazon.com
Amazon.co.uk

Reuters

IN 1381, a mob of angry Essex peasants revolted against the poll tax, and marched on London, destroying tax registers and records as they went. The Essex men wanted an end to their serfdom

and the right to rent land at fourpence an acre. King Richard II, just 14 years old, bowed to their demands and the mob dispersed, although not before invading the Tower of London, trespassing on the royal bedchambers, and killing the Archbishop of Canterbury.

The conflict between mutinous masses and self-preserving elites is the theme of this ambitious, even audacious, book by Daron Acemoglu, of the Massachusetts Institute of Technology, and James Robinson, of Harvard University. Their aim is to figure out when such struggles result in democracy, and when that democracy endures. The peasants' revolt of 1381 was not such a case. Once the uprising had ebbed, the young monarch reneged on his promises to the Essex men, rounded up the surviving ringleaders and had them executed.

As this sorry episode shows, people power is fleeting; sullen discontent flares only rarely and briefly into forceful dissent. This is obviously a problem for rebels, who find it hard to sustain a revolt. But, as this book points out, it also poses a conundrum for the elites who might want to appease them.

It is a king's or dictator's prerogative to change his mind. As the sovereign, he can overrule everyone, including himself. Thus after an insurrection peters out, the sovereign cannot hold himself to any concessions he might have made when the rebels were at his bedroom door. Dissidents should anticipate this. If they do not want to meet the same fate as the Essex men of 1381, they should not settle for the ruler's sops, but push instead for outright revolution while they still can.

This dilemma sets up the book's main thesis: democracy is a solution to the elite's commitment problem. By agreeing to a peaceful extension of the franchise, the elites institutionalise their concessions, and the masses lock in their power before it drifts away. Institutions, such as universal suffrage, are harder to overturn than policies, such as rent of fourpence an acre. It is easy, all too easy, for the elite to renege on a promise to the people; rather harder for it to mount a coup against them.

Uncircumscribed authority can be a handicap. It makes it impossible for the sovereign to make a lasting concession even if he wants to. Such paradoxes are familiar to students of game theory, a subdiscipline of economics on which the authors draw heavily. Game theory sheds light on strategic encounters, in which each player's move must take account of the others'; it is a good way to explore the machinations and manoeuvres of politics.

The authors hope to convert readers to their method as well as their argument. The pace of the book suffers from this laudable pedagogical purpose. They tell the reader what they are going to say, say it, then tell the reader they've said it. Their technical apparatus, like scaffolding, is no doubt a great help in building their theory. But an awful lot of scaffolding is left out on show, which is a great help to anyone teaching this book, but a distraction for those who just want to admire the edifice.

And there is much to admire. True to their title, Messrs Acemoglu and Robinson offer a unified theory of both democracy and its opposite. Some Latin American countries have swung between the two with metronomic regularity. Argentines won universal male suffrage as early as 1912, but lost it to a coup in 1930. Democracy was restored in 1946, overthrown in 1955, re-introduced in 1973, subverted in 1976 and cemented, one hopes, in 1983.

In the authors' eyes, the demise of democracy is a near mirror image of the fall of dictatorship. Anxious incumbents try to buy off the military, much as Richard II sought to placate the Essex men. Chile's Salvador Allende, for example, raised army pay and benefits. But in the long run, a democracy cannot commit itself to serve the interests of anyone but the swing voters. The military elite know this, and take their chances when they can. Allende was duly deposed in 1973.

The book takes its title from “The Social Origins of Dictatorship and Democracy” by Barrington Moore, an American sociologist who died last month. The conclusion of that treatise has been summed up as: “No bourgeoisie, no democracy.” Messrs Acemoglu and Robinson agree that the middle class can be a midwife for democratic rule, not least because the elite is more willing to cede power to merchants than to the mob. They also agree with Moore that agrarian societies tend towards authoritarianism. Land is easier to expropriate than capital; and peasants are easier to repress than factory workers. Thus feudal lords fear democracy more than capitalists do; and have an easier time suppressing it.

Such bold generalisations and pithy dictums have fallen out of fashion since Moore wrote his classic in 1966. One more recent scholar counted no fewer than 27 different factors that are said to promote democracy. This book is entirely free of such intellectual indecision. The authors are brutal wielders of Occam's razor, and the 27 factors have been chopped down to a coherent handful. This may leave a lot out, but what historians bemoan as simplistic, economists tend to celebrate as parsimonious. According to two scholars cited in this book, even to look for a general theory of democratic reform requires great temerity. Happily, Messrs Acemoglu and Robinson have temerity in spades.

Economic Origins of Dictatorship and Democracy.
By Daron Acemoglu and James A. Robinson.
Cambridge University Press; 540 pages; $35 and £25

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Economist.com BOOKS & ARTS

The war on terror

Think again

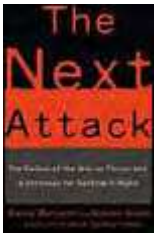
Nov 24th 2005
From The Economist print edition

AMERICA is losing the “war on terror”; the Iraq war distracted policymakers and fuelled Muslim anger; the project to democratise the Middle East is worthy but ill-thought-out; the Bush team has thrown money at homeland defence but lacks a strategy; its Christian moralism inhibits sensible foreign-policymaking; it is only a matter of time before America suffers another deadly attack, perhaps even one involving weapons of mass destruction.

In drawing these individual admonitions together into a single, damning charge sheet, Daniel Benjamin and Steven Simon might be thought of as having an ulterior motive. Both men were members of Bill Clinton's National Security Council; they may have an interest in defending what was done on their watch—and rubbishing what came after.

But to dismiss their book on these grounds would be unfair, for the authors know what they are talking about. Their previous book, “The Age of Sacred Terror”, which came out in 2002, established the pair as authorities on al-Qaeda and its ilk. They are both insiders, and their new book is full of fresh detail.

The Next Attack: The Failure of the War on Terror and a Strategy for Getting It Right
By Daniel Benjamin and Steven Simon



Times Books; 330 pages; $26.
Hodder & Stoughton; £8.99

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Amazon.com
Amazon.co.uk

Central to their argument is the charge that the Bush administration has consistently underestimated the enemy. George Bush's claim that “75 per cent of known al-Qaeda leaders have been brought to justice” is dubious to say the least, and by indicating that America is on course for victory, it exudes a false optimism. The Madrid and London bombings suggest an evolving threat with disturbing long-term implications.

A second problem has been the administration's obsession with states and state-sponsored terrorism, despite the fact that al-Qaeda's global network has been far less reliant on state support than other, older terrorist groups. On the question of Iraqi weapons of mass destruction, the authors insist the real issue was not whether Saddam Hussein had them but whether he would use them. They are sceptical of the idea (central to the administration's case) that he would supply them to al-Qaeda, a group he could not control and which followed an ideology that was at odds with his own.

In the same way as previous whistle-blowers have done, these authors paint a portrait of an administration which, in its impatience to go to war, was ready to short-circuit the normal policymaking process with its tedious checks and balances. And they regard Dick Cheney, Donald Rumsfeld and Paul Wolfowitz together as representing something close to a “parallel foreign policy apparatus”.

Whatever its rationales, America's intervention has turned Iraq into the cockpit of the new *jihad*. “The terrorists have found in Iraq a better sanctuary, training ground and laboratory than they

ever had in Afghanistan." The Iraq war and the continuing occupation have also given a powerful, if spurious, validation to the jihadist claim that America is at war with Islam.

Looking beyond Iraq, the authors share the administration's view that "democratic transformation" of the broader Middle East is a noble ideal. Like others, though, they detect a gap between rhetoric and reality. They take the tough-minded view that, if policymakers are serious, they must put direct pressure on autocratic leaders rather than taking the easier route of promoting civil society. They see an object lesson in the way Turkey has transformed itself in order to meet the criteria for European Union membership. If Europe could impose such "conditionality" on Turkey, why could America not do something similar with Egypt?

This is a policy book. There is scarcely a hint of history in it. It appears to have been written and published quickly. In the last chapter, the authors acknowledge that the neo-conservative view has become less influential in Mr Bush's second term, and that a review of counter-terrorism strategy is also under way. This implicitly takes a little of the sting out of their critique. But in its account of what has gone wrong and in its call for fresh thinking, the book is nonetheless rooted in realism.

The Next Attack: The Failure of the War on Terror and a Strategy for Getting It Right
By Daniel Benjamin and Steven Simon
Times Books; 330 pages; $26.
Hodder & Stoughton; £8.99

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Economist.com BOOKS & ARTS

Ivy League universities

Merit in motion

Nov 24th 2005
From The Economist print edition

AMERICANS justify their country's comparatively high social inequality by emphasising its equality of opportunity. The implication is that it is talent and hard work, not inherited privilege, which separate the rich from the poor.

The linchpin of such a meritocratic perspective is the educational system, which effectively allows access to the top of the socioeconomic ladder through the process of university admissions. America's big three universities (Harvard, Yale and Princeton) have for centuries created and reproduced the national elite, and have long sworn fealty to the principle of egalitarian opportunity. But in “The Chosen”, an encyclopedic and engaging account of their admissions over the last century, Jerome Karabel, a professor of sociology at the University of California, Berkeley, demolishes their historical claim to be bastions of meritocracy. More provocatively, he questions the whole idea of whether you can define merit objectively, and instead uses painstaking archival research to prove that, over the years, the Ivy League universities have defined and redefined merit according to their shifting institutional priorities.

The Chosen: The Hidden History of Admission and Exclusion at Harvard, Yale, and Princeton
By Jerome Karabel

Houghton Mifflin; 720 pages; $28

Buy it at
Amazon.com
Amazon.co.uk

“The Chosen” highlights two critical turning points: the birth in the 1920s of selective admissions that introduced subjective non-academic merit as a criteria for acceptance, and the universities' dramatic shift in the direction of socioeconomic inclusivity in the 1960s, when they re-tooled the concept of merit to open their doors to racial minorities and women.

When Mr Karabel picks up the story shortly after 1900, the colleges were becoming increasingly concerned about the number of Jews who were passing the entrance exams. Since the Protestant upper classes who paid tuition bills had deserted other universities, notably Columbia, where “Hebrew” enrolments were deemed excessive, administrators regarded the increased Jewish presence as both a cultural insult and a threat to their institutional viability.

As a result, the colleges limited the size of their classes and began to reject students by creating a definition of merit that was expressly designed to justify quotas on Jewish applicants. Academic achievement would play second fiddle to the character and manliness thought to be inculcated by prestigious boarding schools. Jews (limited to 15% of the class at Harvard and 10% at Yale) were deemed lacking in these attributes. In the words of a former Harvard dean of admissions, Wilbur Bender, Jews were “effeminates, the precious and affected, the unstable”, while private school boys were “virile, masculine, red-blooded he-men”.

The three universities continued to find character almost exclusively in wealthy Protestant boys until the 1960s, when external social upheaval changed their institutional priorities. The student takeovers of university buildings and the violent race riots of that era caused administrators to

fear for campus security, and they sought to avoid such disturbances by admitting (and, implicitly, co-opting) more black students. Since few black applicants had high test scores, the admissions definition of merit again had to be turned upside down. Character suddenly stemmed from socioeconomic adversity rather than privilege. Once the principle of diversity as merit was established, all-male Yale and Princeton were hardly in a position to reject the demands of the feminist movement for co-education, which they implemented around 1970.

The central thesis that Mr Karabel draws from this history is that the universities have always determined their merit criteria according to the admissions outcomes that would suit their institutional interests, rather than the other way around. Although he credits the three universities with becoming more accessible to the underprivileged, he notes that even today, the wealthy are still vastly overrepresented among their student bodies. This is partly due to the donation-friendly admissions preferences still given to athletes and children of alumni, which he concludes should be abolished.

But eliminating these practices won't turn these institutions into a meritocratic mecca because, as Mr Karabel argues, the concept of meritocracy itself is strategic and flexible, and often in outright conflict with egalitarian aims. “Those who are able to define ‘merit',” he writes, “will almost invariably possess more of it, and those with greater resources—cultural, economic, and social—will generally be able to ensure that the educational system will deem their children more meritorious.” Even today, efforts at Harvard to place more emphasis on the sciences (potentially replacing some wealthier white students with nerdy Asian-Americans) have attracted criticism that they might make the student body too one-dimensional instead of iconoclastic and well-rounded—exactly the same style of disparaging argument used to justify the Jewish quotas of yesteryear. As the book concludes, the unsettling lesson to be learned from a century of purported Ivy League meritocracy is that “the ideal of a meritocracy...is inherently unattainable.”

The Chosen: The Hidden History of Admission and Exclusion at Harvard, Yale, and Princeton
By Jerome Karabel
Houghton Mifflin; 720 pages; $28

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Caravaggio

The discovery of temptation

Nov 24th 2005
From The Economist print edition

IN AUGUST 1990, an Italian art restorer at the National Gallery of Ireland was called to St Ignatius Residence, the home of the Jesuit priests in Dublin. Father Noel, the rector, wanted Sergio Benedetti's advice on the half-dozen or so religious paintings that hung there and whether they needed cleaning.

The Lost Painting: The Quest for a Caravaggio Masterpiece
By Jonathan Harr

Random House; 270 pages; $24.95

Buy it at
Amazon.com
Amazon.co.uk

Once inside, Mr Benedetti was shown several early 20th-century Irish paintings of little consequence, and an Italian work, possibly 16th century, but provincial and clumsily executed. Then he turned to the largest painting, a betrayal of Christ. Its dark surface was obscured by a film of dust, grease and soot, the result of hanging in a room with a coal fire. The varnish had yellowed, giving the flesh tones a tobacco-tinted hue. Christ's robe had turned the colour of dead leaves, though Mr Benedetti thought it might once have been red. The canvas was slack in its frame; clearly the painting had not been cleaned or relined in more than a century.

A little over two years later, the National Gallery announced that it had discovered “The Taking of Christ”, a masterpiece of the Italian Baroque by Caravaggio. Wrongly attributed to a minor Dutch painter, it had vanished two centuries earlier when it was bought on the cheap by a Scottish collector. As a first-class Caravaggio, it was priceless.

Jonathan Harr has taken the story of the lost painting, and woven from it a deeply moving narrative about history, art and taste—and about the greed, envy, covetousness and professional jealousy of people who fall prey to obsession. It is as perfect a work of narrative non-fiction as you could ever hope to read.

He begins, not with Mr Benedetti, who joins the story only halfway through the book, but with two young art-history students in Rome. Their turbulent journey through the Darwinian world of Rome university (the second biggest in the world after Cairo) and their quest to break into the locked private archive of one of Caravaggio's most important patrons are interspersed with leaves from Caravaggio's own turbulent life. He drank too much and got into fights, and was so poor that he made the priming layer for “The Taking of Christ” by grinding up the leftover paint from his palette. Read and enjoy.

The Lost Painting: The Quest for a Caravaggio Masterpiece.
By Jonathan Harr.
Random House; 270 pages; $24.95

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Economist.com BOOKS & ARTS

Brands and branding

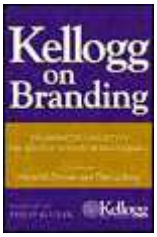
The last word

Nov 24th 2005
From The Economist print edition

THE *Wall Street Journal*/Harris Interactive ranking of the world's best business schools is unique in that it is based solely on the views of recruiters, the companies that employ the schools' graduates. It is also unique in that it asks recruiters for their opinions of the various schools' different academic disciplines, including finance, strategy and marketing. In some of these categories, individual schools stand head and shoulders above their rivals. This year, for example, Harvard Business School received more than five times as many accolades for strategy as did the runner-up in the category.

But in one category there is a business school that stands head, shoulders, torso and trunk above the rest. The Kellogg School of Management, part of Northwestern University near Chicago and named after John L. Kellogg, son of the founder of the cereal company, is the world's leading academic authority on marketing—by miles and miles. In the *Wall Street Journal* poll it received 1,304 accolades for its excellence in this discipline. Its nearest rival received a mere 123 nominations; Harvard 89.

Kellogg on Branding
By the Kellogg School of Management.
Edited by Alice M. Tybout and Tim Calkins.



John Wiley; 334 pages; $29.95 and £18.99

Buy it at
Amazon.com
Amazon.co.uk

So a book with the title “Kellogg on Branding” arouses high expectations. And this collection of essays, written by professors and other academics associated with the school, does not disappoint. Branding is a powerful weapon in today's marketing armoury; it can lift an indifferent product to cult status and high margins. The book defines it as “a set of associations linked to a name, mark, or symbol associated with a product or service—a brand is much like a reputation”. It is the difference between a Harley-Davidson and A.N. Other Bike. Water is merely a fungible commodity until it becomes a brand in a bottle. There is no shortage of books giving advice on how to weave this particular business magic. If you have time to read only one of them, make sure it is this one.

The book is rich in stories, recounting, for example, how close the BlackBerry mobile communications device came to being prosaically called PocketLink, and how Procter & Gamble dangerously let go of its White Cloud brand of toilet tissue. It is also rich in insights: showing how companies that are successful at branding are either a house of brands—like Nestlé, which owns some 8,000 of them—or a “branded house”, like Dell or the Virgin Group, where everything produced by the firm carries the same name.

There is a description of what it takes to shift brand names from our short-term memory (where they live perilously, always in danger of falling out) to our longer-term memory, where they are more likely to stick, to be called upon later. There is a chapter on branding services, “where the frontline employee is the brand for the customer”; branding technology and valuing brands. And there are short chapters by practitioners, marketing folks in real companies who tussle with the issues of branding day in, day out.

There is also an intriguing chapter by an anthropologist, John Sherry, who describes a brand as “a mental shortcut that discourages rational thought, an infusing with the spirit of the maker.” Some are so infused that they have brands literally branded on their skin, carrying tattoos of their totem products—be they Apple's iMac or a Gibson guitar.

One criticism of the book, and indeed of the Kellogg school itself, is that it is not an international brand. Although BMW and Richard Branson, the founder of the Virgin airline, get a mention, the book's examples come predominantly from America—as do its authors. But branding is an area of business where Europeans compete full-on with Americans. Think only of Gucci, Porsche, L'Oréal and Johnnie Walker. It would enrich the next edition of the book if its editors were to call upon at least one non-American author.

Kellogg on Branding.
Tim Calkins
John Wiley; 334 pages; $29.95 and £18.99

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New cinema

It's all connected

Nov 24th 2005
From The Economist print edition

“Syriana” does for the oil market what “Traffic” did for the drug trade

Fatface

GEORGE CLOONEY put on 35 pounds to play Bob Barnes, one of the five characters caught up in this complicated tale about two American oil majors that are set on a corporate merger. Barnes, a CIA operative loosely based on Robert Baer, the author of “See No Evil: The True Story of a Ground Soldier in the CIA's War on Terrorism”, is sent out to the mythical Arab state of Syriana on what he believes is an anti-terrorist mission. Just a bit too late, he realises that he is nothing more that a small cog in the machine that delivers oil to American consumers at affordable prices.

Matt Damon co-stars as the idealistic young economic adviser to an idealistic Gulf prince (Alexander Siddig) who wants to liberalise his nation. A young Pakistani oilworker (Mazhar Munir) loses his job as a result of the merger and joins a *madrassa* that is recruiting suicide-bombers to fight the Americans. And Jeffrey Wright, the film's most intriguing character, is an ambitious lawyer hired to beat federal investigators in sniffing out the bribe everyone assumes was paid so the deal would go through. “We are talking about the oil business here, aren't we?” asks an incredulous board member of one of the merged companies when Mr Wright first appears on the scene.

Robert Elswit's subtly stylised cinematography weaves a tapestry out of the five characters' perspectives. Stephen Gaghan used different colours to paint his narratives in “Traffic”; in his new film, Langley and this corner of Arabia are visually on the same planet, separated only by an ever-shrinking space that one satellite-guided smart bomb can bridge in an instant.

Syriana's politics are not those of Mr Baer's book or its 2003 follow-up, “Sleeping With the Devil: How Washington Sold Our Soul for Saudi Crude”, but the same moral outrage fuels the plot. Mr Clooney's second foray this year into political drama should succeed handsomely. In a season when other writers have also made a successful transition to directing, the Oscar-winning Mr Gaghan just moved to the head of the class.

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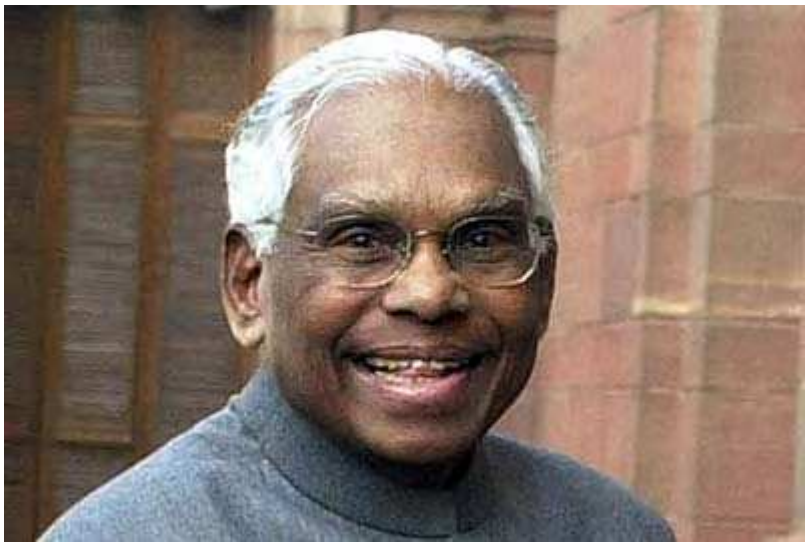
Obituary

K.R. Narayanan

Nov 24th 2005
From The Economist print edition

Kocheril Raman Narayanan, a former president of India, died on November 9th, aged 85

AP



Get article background

DESPITE the fact that India is stratified by age-old hierarchies, in no other poor country has democracy struck such deep roots so quickly. The life of K.R. Narayanan suggests an answer to the puzzle. He was born at the very bottom, into the group of “out-castes” once called “untouchable” and now known as *dalits*. Yet he rose to the top, serving as the country's president from 1997 to 2002.

Caste in India is the social expression of the belief of many Hindus that birth is destiny. To whom you are born determines how you will live. There are four main divisions—priests, warriors, traders and workers—but over 5,000 years the caste system has evolved into a bewilderingly complex matrix of thousands of sub-castes. Underneath it all are the *dalits*, more than 200m of them today.

It was into this group that Mr Narayanan was born, one of seven children, in a small village in the southern Indian state of Kerala. His father, a practitioner of herbal medicine, helped him go to a school run by Christian missionaries. For the 15km (ten-mile) daily walk he had to borrow sandals. His brother recalled finding him in tears after one of many humiliations when his school fees were overdue.

A supremely talented student, he won a scholarship and went to college in the state capital. Again he starred but, because of his caste, was refused the teaching job that his exam results should

have guaranteed. Instead, he was offered a post as a clerk. Outraged, Mr Narayanan sought an audience with the local maharajah, who refused to see the untouchable upstart. Though friends remember Mr Narayanan as gentle and courteous, he had the stubbornness born of a lifelong fight against injustice. Having boycotted the degree ceremony at his college, he had the satisfaction of accepting the honour he had earned 50 years later, as a national hero.

Academic brilliance won him a scholarship from a philanthropic industrialist and took him, just as the second world war ended, to the London School of Economics. He studied under Harold Laski, mentor of many leading figures in Britain's former colonies. He returned to India in 1948, armed with a letter of introduction from Laski to Jawaharlal Nehru, prime minister of India since its independence the previous year. Nehru found him a job in the diplomatic service, where he flourished, becoming ambassador to Thailand, Turkey, China and—as a political appointee after his retirement—to America.

In 1984 he entered politics, as a member of parliament for the ruling Congress party in a Kerala constituency. In 1992 he was nominated as the country's vice-president, taking the top job five years later. He filled the largely ceremonial post, which comes with the 340-room palace built for Britain's last viceroys, with distinction. He was no rubber stamp. Twice, on constitutional grounds, he questioned the government's decision to sack state governments. He also challenged the tradition that, after an election, the largest party automatically gets the chance to form a government, insisting it show evidence of a parliamentary majority.

He was doubtless proud of what his status implied for others of his caste, but disappointed that he would always be identified as “India's first *dalit* president”. There was a diplomatic kerfuffle when he visited France in 2000, and a headline in *Le Figaro* proclaimed: “An untouchable at the Elysée”. But he had lived with this kind of behaviour from the Indian press for the previous three years. Kuldip Nayar, a well-known commentator, agreed that “India is the real guilty party. The manner in which the elite of upper castes parade the small progress the untouchables, the *dalits*, have made betrays a haughty attitude.”

The bottom of the heap

Discrimination on grounds of caste is now illegal. A huge affirmative-action scheme covering places in colleges and civil-service jobs is written into India's constitution. But the tenacity of the caste system is made plain by the matrimonial-help pages of the Sunday newspapers. Many parents expect their children to marry within their caste, and many children concur.

At the bottom of the heap, hideous discrimination persists. Traditionally, *dalits* were unclean—they were excluded from the places where the upper castes worship, eat and drink, and were employed to deal with, for example, corpses and excrement. Even now, there is violence against *dalits* who have broken taboos. And although caste no longer dictates employment, some ugly abuses survive. “Manual scavenging”, for example, a euphemism for the practice of removing human and animal excreta from latrines by hand, is outlawed but has not been eradicated. Manual scavengers are considered “polluted” and live in segregated settlements.

As Mr Narayanan mildly put it in 1998, “The march of society, of social change, has not been fast enough, nor fundamental enough, so far.” But, speaking of himself, he also said: “My life encapsulates the ability of the democratic system to accommodate and empower marginalised sections of society.” As he realised, it is in fact not a puzzle at all that India's hierarchical traditions should adapt so readily to democracy. Indians such as he were quick to realise that no other form of government offers such hopes of upward mobility.

Overview

Nov 24th 2005
From The Economist print edition

A rise in **euro-area** borrowing costs now looks almost certain following remarks by Jean-Claude Trichet, president of the European Central Bank, on November 18th. Mr Trichet signalled an increase on December 1st in the ECB's refinancing rate, which has been held at 2.0% since June 2003.

An unexpected fall in **industrial output** cast some doubt on the recovery in the euro area. After rising for three consecutive months, production dropped by 0.4% in September. However, **industrial new orders** rose by 1.1% in September. The picture varied across the euro area. In Germany, orders increased by 3.3% whereas they declined by 3.8% in Italy. The euro area's 12-month **current-account surplus** shrank again in September to $1.4 billion.

While interest rates are heading up in the euro area, the steady tightening of monetary policy in **America** since the middle of last year may be coming to an end. The minutes of the meeting of the Federal Reserve's rate-setting committee on November 1st were widely interpreted as dovish. The financial markets focused particularly on a passage where some members of the committee referred to “risks of going too far with the tightening process”.

The latest batch of figures painted a mixed picture of the American economy. **Industrial output**, which had fallen steeply in September because of a strike at Boeing and disruptions from hurricanes, rebounded in October. Production rose by 0.9%, the fastest rate for a year and a half. However, the overheated **housing market** appears to be cooling faster than expected. Housing starts fell by 5.6% in October and there was a 6.7% drop in the number of permits for new construction.

Canadian inflation declined from 3.4% in the 12 months to September to 2.6% in October, thanks to falling petrol prices. Core inflation—stripping out food and energy—eased from 1.6% in September to 1.5% in October.

In **Britain**, minutes of the meeting of the Bank of England's monetary-policy committee on November 10th revealed a unanimous vote among its nine members to keep interest rates at 4.5%. **Manufacturers** have become more pessimistic about their expected output despite improved export orders, according to a survey by the Confederation of British Industry.

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Output, demand and jobs

Nov 24th 2005
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2005	2006	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.6	Q2	+ 5.2	+ 2.7	+ 3.3	+ 0.7	Q2	+ 1.2	Q3	5.2	Oct	5.3
Austria	+ 2.1	Q2	+ 1.8	+ 1.6	+ 1.9	+ 4.4	Aug	+ 6.5	Aug	5.3	Oct	4.9
Belgium	+ 1.1	Q3	+ 1.6	+ 1.3	+ 1.8	– 3.9	Sep	+ 7.4	Aug	13.2	Oct†	13.2
Britain	+ 1.6	Q3	+ 1.6	+ 1.8	+ 2.1	– 1.1	Sep	+ 1.5	Oct	4.7	Sep††	4.7
Canada	+ 2.7	Q2	+ 3.2	+ 2.9	+ 3.0	+ 1.7	Aug	+ 4.9	Aug	6.6	Oct	7.1
Denmark	+ 4.3	Q2	+ 6.6	+ 2.2	+ 2.2	+ 2.0	Sep	+ 8.4	Sep	5.5	Sep	6.3
France	+ 1.8	Q3	+ 2.7	+ 1.5	+ 1.7	+ 0.2	Sep	+ 2.6	Sep	9.8	Sep	10.0
Germany	+ 1.4	Q3	+ 2.5	+ 0.9	+ 1.3	+ 3.3	Sep	– 0.7	Sep	11.6	Oct§	10.7
Italy	nil	Q3	+ 1.2	+ 0.2	+ 1.2	– 1.7	Sep	+ 1.1	Aug	7.7	Jun	8.1
Japan	+ 3.0	Q3	+ 1.7	+ 2.3	+ 2.0	+ 1.2	Sep	+ 0.4	Sep	4.2	Sep	4.6
Netherlands	+ 0.9	Q3	+ 1.3	+ 0.7	+ 1.7	+ 1.6	Sep	+ 1.9	Aug	6.5	Oct**	6.5
Spain	+ 3.2	Q3	+ 3.5	+ 3.4	+ 3.0	+ 0.5	Sep	+ 1.9	Sep	9.3	Sep	10.8
Sweden	+ 2.3	Q2	+ 2.6	+ 2.3	+ 2.8	nil	Sep	+ 6.5	Sep	5.6	Oct†	4.9
Switzerland	+ 1.0	Q2	+ 1.1	+ 1.1	+ 1.6	+ 3.9	Q2	+ 4.7	Aug	3.7	Oct†	3.7
United States	+ 3.6	Q3	+ 3.8	+ 3.6	+ 3.3	+ 1.9	Oct	+ 2.6	Sep	5.0	Oct	5.5
Euro area	+ 1.5	Q3	+ 2.6	+ 1.3	+ 1.6	+ 1.0	Sep	+ 0.9	Sep	8.4	Sep	8.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 1.7	Q3	+ 7.8	na	na	– 0.8	Sep	+ 5.5	Sep	8.1	Oct	8.7
Greece	+ 3.7	Q3	na	na	na	+ 0.1	Sep	+ 3.9	Aug	9.6	Q2	10.2
Iceland	+ 6.8	Q2	na	na	na	na		na		1.4	Sep†	2.6
Ireland	+ 4.1	Q2	+ 6.5	na	na	+ 0.4	Sep	+ 4.2	Aug	4.4	Oct	4.4
Luxembourg	+ 3.1	Q1	na	na	na	+15.8	Aug	+ 1.2	Sep	4.7	Sep	4.2
New Zealand	+ 2.6	Q2	+ 4.5	na	na	– 1.5	Q2	+ 4.9	Q3	3.4	Q3	3.8
Norway	+ 4.8	Q2	+ 5.2	na	na	+ 5.0	Sep	+ 4.2	Sep	4.8	Sep‡	4.5
Portugal	+ 0.5	Q2	+ 4.1	na	na	+ 0.1	Sep	+ 2.5	Sep	7.7	Q3†	6.8

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ††Jul-Sep; claimant count rate 2.8% in Oct.
§EU harmonised rate 8.7% in Sep. **Aug-Oct.

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Prices and wages

Nov 24th 2005
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2005	2006	latest		year ago	latest		year ago
Australia	+ 3.0	Q3	+ 2.3	+ 2.8	+ 2.7	+ 6.2	Q3	+ 6.1	+ 6.1	Q3	+ 3.5
Austria	+ 2.0	Oct	+ 2.6	+ 2.2	+ 2.0	+ 1.3	Oct	+ 6.0	+ 2.3	Oct	+ 2.0
Belgium	+ 2.5	Oct	+ 2.9	+ 2.5	+ 2.2	+ 1.6	Oct	+ 6.0	+ 2.5	Jul	+ 2.2
Britain	+ 2.3	Oct*	+ 1.2	+ 2.2	+ 2.2	+ 2.6	Oct	+ 3.5	+ 4.1	Sep†	+ 3.8
Canada	+ 2.6	Oct	+ 2.3	+ 2.4	+ 2.5	+ 0.6	Sep	+ 4.8	+ 1.1	Aug	+ 2.0
Denmark	+ 2.0	Oct	+ 1.7	+ 1.8	+ 1.9	+ 4.3	Oct	+ 3.6	+ 2.9	Q2	+ 3.1
France	+ 1.8	Oct	+ 2.1	+ 1.9	+ 1.7	+ 3.4	Sep	+ 3.0	+ 3.2	Q3	+ 2.9
Germany	+ 2.3	Oct	+ 2.0	+ 2.0	+ 1.9	+ 2.7	Oct	+ 4.2	+ 1.1	Sep	+ 1.0
Italy	+ 2.2	Oct	+ 2.0	+ 2.1	+ 2.1	+ 3.8	Sep	+ 3.8	+ 3.1	Sep	+ 2.5
Japan	– 0.3	Sep	nil	– 0.1	+ 0.3	+ 1.9	Oct	+ 2.1	– 0.2	Sep	+ 1.6
Netherlands	+ 1.6	Oct	+ 1.4	+ 1.5	na	+ 5.3	Sep	+ 6.1	+ 1.0	Oct	+ 0.9
Spain	+ 3.5	Oct	+ 3.6	+ 3.3	+ 3.1	+ 5.4	Sep	+ 4.6	+ 3.4	Q2	+ 3.1
Sweden	+ 0.5	Oct	+ 0.8	+ 0.8	+ 1.5	+ 4.2	Sep	+ 2.1	+ 3.0	Aug	+ 2.6
Switzerland	+ 1.3	Oct	+ 1.3	+ 1.3	+ 1.2	+ 1.0	Oct	+ 2.0	+ 0.9	2004	+ 1.4
United States	+ 4.3	Oct	+ 3.2	+ 3.4	+ 3.1	+ 5.9	Oct	+ 4.4	+ 2.9	Oct	+ 2.6
Euro area	+ 2.5	Oct	+ 2.4	+ 2.2	+ 1.9	+ 4.4	Sep	+ 3.3	+ 2.3	Q2	+ 2.1
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.8	Oct	+ 0.9	na	na	+ 3.3	Oct	+ 3.0	+ 3.6	Q3	+ 4.0
Greece	+ 3.8	Oct	+ 3.2	na	na	+ 6.7	Sep	+ 4.9	na		na
Iceland	+ 4.2	Nov	+ 3.8	na	na	+ 4.2	Oct	+ 5.6	+ 6.9	Oct	+ 5.3
Ireland	+ 3.0	Oct	+ 2.7	na	na	– 0.2	Sep	– 0.8	+ 3.4	Q2	+ 4.3
Luxembourg	+ 3.1	Oct	+ 2.5	na	na	+ 2.5	Sep	+15.1	+ 1.2	Aug	+ 2.3
New Zealand	+ 3.4	Q3	+ 2.5	na	na	+ 6.1	Q3	+ 2.5	+ 3.0	Q3	+ 2.2
Norway	+ 1.8	Oct	+ 1.4	na	na	+10.1	Oct	+24.1	+ 3.8	Q2	+ 4.1
Portugal	+ 2.7	Oct	+ 2.1	na	na	+ 4.1	Oct	+ 5.3	– 1.4	Sep	– 0.8

*RPI inflation rate 2.5% in Oct. †Jul-Sep.

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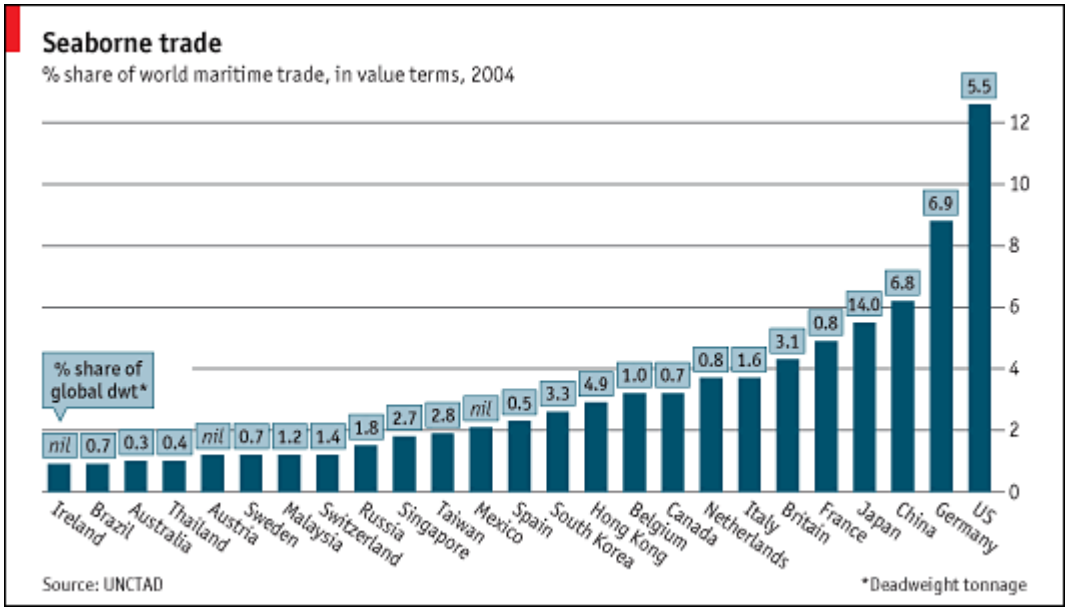
Seaborne trade

Nov 24th 2005
From The Economist print edition

The shipping news was good last year, according to UNCTAD. The world's sea lanes carried more than 6.7 billion tonnes of merchandise in 2004, up 4.3% from 2003. Almost 40% of this tonnage originated in Asia. As cargoes grow, so does the world's shipping fleet. Its capacity, measured in "deadweight tonnage" (the maximum weight of cargo, crew and fuel) was almost 896m at the start of 2005.


Seaborne trade
% share of world maritime trade, in value terms, 2004
% share of global dwt*
nil 0.7 0.3 0.4 nil 0.7 1.2 1.4 1.8 2.7 2.8 nil 0.5 3.3 4.9 1.0 0.7 0.8 1.6 3.1 0.8 14.0 6.8 6.9 5.5
0 2 4 6 8 10 12
Ireland Brazil Australia Thailand Austria Sweden Malaysia Switzerland Russia Singapore Taiwan Mexico Spain South Korea Hong Kong Belgium Canada Netherlands Italy Britain France Japan China Germany US
Source: UNCTAD
*Deadweight tonnage

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Money and interest rates

Nov 24th 2005
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Nov 23rd 2005)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 7.6	+ 9.8	Sep	5.61	5.44	5.20	5.35	5.38	6.47
Britain	+ 5.2	+11.6	Oct	4.56	4.81	4.26	4.20	4.61	5.16
Canada	+10.9	+ 9.8	Sep	3.21	2.66	3.68	4.03	4.43	5.26
Denmark	+19.0	+14.1	Oct	2.45	2.25	2.82	3.44	3.77	4.97
Japan	+ 5.4	+ 2.0	Oct	0.02	0.03	0.23	1.48	1.42	1.55
Sweden	+ 2.8	+ 5.6	Sep	1.51	2.03	2.36	3.34	4.01	3.19
Switzerland	+ 4.0	+ 6.2	Oct	0.97	0.75	1.61	2.21	2.35	2.29
United States	+ 0.5	+ 7.3	Oct	4.06	2.23	4.35	4.51	4.20	5.45
Euro area†	+11.2	+ 8.5	Sep	2.44	2.17	2.72	3.43	3.70	3.81

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.70%, Japan No. 273 1.47%. Central bank rates: US fed funds 4.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.5%. Sources: Bank of Canada, Commerzbank, Danske Bank, J.P. Morgan Chase, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Nov 24th 2005
From The Economist print edition

2000=100

	Nov 15th	Nov 22nd*	% change on one month	% change on one year
Dollar index				
All items	136.4	136.5	+ 1.0	+10.0
Food	123.0	122.3	– 1.7	+ 4.6
Industrials				
All	153.8	155.0	+ 4.0	+16.2
Nfa†	132.7	132.6	– 1.9	+ 9.3
Metals	165.3	167.2	+ 6.8	+19.5
Sterling index				
All items	119.4	121.0	+ 5.4	+20.3
Euro index				
All items	108.0	107.8	+ 4.3	+22.9
Yen index				
All items	150.8	151.0	+ 5.1	+26.7
Gold				
$ per oz	468.05	491.75	+ 4.1	+ 9.7
West Texas Intermediate				
$ per barrel	57.68	58.28	– 6.5	+19.5

* Provisional. † Non-food agriculturals.

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Stockmarkets

Nov 24th 2005
From The Economist print edition

Market indices

	Nov 23rd	2005 high	2005 low	% change on one week	% change on record high	% change on Dec 31st 2004 in local currency	% change on Dec 31st 2004 in $ terms
Australia (All Ordinaries)	4,562.4	4,617.4	3,905.5	nil	- 1.2	+12.6	+ 6.0
Austria (ATX)	3,463.0	3,503.9	2,415.0	+ 3.4	- 1.2	+42.4	+23.6
Belgium (Bel 20)	3,400.2	3,400.2	2,958.8	+ 1.1	- 7.7	+15.9	+ 0.6
Britain (FTSE 100)	5,531.7	5,531.7	4,783.6	+ 1.9	-20.2	+14.9	+ 3.0
Canada (Toronto Composite)	10,919.8	11,081.2	9,006.2	+ 1.8	- 4.1	+18.1	+20.8
Denmark (OMXCB)	347.6	347.6	257.8	+ 1.8	nil	+34.8	+16.6
France (SBF 250)	3,214.0	3,248.3	2,633.6	+ 2.1	-26.8	+22.0	+ 5.8
(CAC 40)	4,608.7	4,650.2	3,816.1	+ 2.1	-33.4	+20.6	+ 4.6
Germany (DAX)*	5,196.1	5,196.1	4,178.1	+ 2.3	-35.6	+22.1	+ 5.9
Italy (S&P/MIB)	34,411.0	34,874.0	30,645.0	+ 2.2	-31.3	+11.4	- 3.4
Japan (Nikkei 225)	14,708.3**	14,708.3	10,825.4	+ 3.8	-62.2	+28.0	+10.5
(Topix)	1,526.5**	1,531.7	1,109.2	+ 2.7	-47.1	+32.8	+14.6
Netherlands (AEX)	419.8	419.8	347.0	+ 2.2	-40.2	+20.6	+ 4.6
Spain (Madrid SE)	1,144.8	1,176.9	950.9	+ 2.1	- 2.7	+19.4	+ 3.5
Sweden (Affarsvarlden Gen)	279.1	279.1	218.9	+ 1.4	-30.3	+26.2	+ 3.9
Switzerland (Swiss Market)	7,495.2	7,495.2	5,669.6	+ 3.1	-10.9	+31.7	+13.8
United States (DJIA)	10,916.1	10,940.6	10,012.4	+ 2.3	- 6.9	+ 1.2	+ 1.2
(S&P 500)	1,265.6	1,265.6	1,137.5	+ 2.8	-17.1	+ 4.4	+ 4.4
(NASDAQ Comp)	2,260.0	2,260.0	1,904.2	+ 3.3	-55.2	+ 3.9	+ 3.9
Europe (FTSEurofirst 300)†	1,247.9	1,247.9	1,038.6	+ 1.9	-26.8	+19.8	+ 3.9
Euro area (FTSE Euro 100)†	1,055.5	1,056.1	894.4	+ 2.2	-31.9	+17.1	+ 1.6
World (MSCI)‡	1,243.8	1,243.8	1,115.0	+ 3.0	-14.1	+ 6.4	+ 6.4
World bond market (Citigroup)††	613.7	662.3	608.7	+ 0.7	- 7.3	- 7.9	- 7.9

*Total return index. †In euro terms. ‡Morgan Stanley Capital International Index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms. **Nov 22nd.

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Trade, exchange rates and budgets

Nov 24th 2005
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2005	2006	Exchange rate trade-weighted† 2000=100 Nov 23rd	year ago	Currency units per $ Nov 23rd	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2005‡
Australia	− 16.1	Sep	− 43.1	Q2	− 4.7	− 5.3	117.9	115.9	1.35	1.27	2.33	1.60	1.14	+ 0.9
Austria	− 1.2	Aug	+ 0.2	Sep	− 0.2	− 0.3	104.0§	104.1	0.85	0.76	1.46	–	0.71	− 2.0
Belgium	+ 15.3	Sep	+ 9.2	Jun	+ 2.4	+ 2.4	104.5§	104.6	0.85	0.76	1.46	–	0.71	− 0.5
Britain	−116.7	Sep	− 43.6	Q2	− 2.2	− 2.4	97.8	98.9	0.58	0.53	–	0.68	0.49	− 2.9
Canada	+ 48.8	Sep	+ 16.3	Q2	+ 1.6	+ 1.5	124.3	120.8	1.17	1.18	2.02	1.38	0.99	+ 1.2
Denmark	+ 10.4	Sep	+ 11.0	Sep	+ 2.8	+ 2.5	105.9	106.5	6.33	5.65	10.9	7.46	5.33	+ 1.8
France	− 27.7	Sep	− 28.4	Sep	− 1.0	− 0.8	107.0§	107.2	0.85	0.76	1.46	–	0.71	− 3.0
Germany	+203.9	Sep	+113.6	Sep	+ 3.7	+ 3.5	104.8§	104.9	0.85	0.76	1.46	–	0.71	− 3.5
Italy	− 10.4	Sep	− 27.8	Sep	− 1.3	− 1.4	76.6§	76.7	0.85	0.76	1.46	–	0.71	− 4.4
Japan	+102.2	Sep	+111.1	Sep	+ 3.3	+ 3.3	81.7	90.0	119	103	204	140	–	− 6.1
Netherlands	+ 39.8	Sep	+ 44.3	Q3	+ 3.6	+ 3.6	103.9§	104.1	0.85	0.76	1.46	–	0.71	− 2.2
Spain	− 93.9	Sep	− 79.0	Aug	− 6.6	− 6.6	77.3§	77.3	0.85	0.76	1.46	–	0.71	+ 0.5
Sweden	+ 21.3	Sep	+ 27.9	Q2	+ 7.1	+ 6.5	94.0	101.9	8.07	6.78	13.9	9.51	6.80	+ 0.8
Switzerland	+ 7.0	Oct	+ 51.4	Q2	+12.3	+11.7	106.4	110.1	1.32	1.15	2.26	1.55	1.11	− 1.0
United States	−753.2	Sep	−749.7	Q2	− 6.5	− 6.6	88.0	80.4	–	–	1.72	1.18	0.84	− 4.1
Euro area	+ 47.3	Sep	+ 1.4	Sep	+ 0.1	+ 0.1	115.5	118.5	0.85	0.76	1.46	–	0.71	− 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 11.7	Sep	+ 8.0	Sep	na	na	81.5§	81.6	0.85	0.76	1.46	–	0.72	+ 1.3
Greece	− 33.8	Aug	− 16.5	Sep	na	na	59.9§	60.0	0.86	0.76	1.48	–	0.72	− 3.8
Iceland	− 1.3	Sep	− 1.6	Q2	na	na	106.7**	96.1	62.9	66.2	108	74.2	53.0	+ 1.1
Ireland	+ 40.6	Sep	− 3.9	Q2	na	na	94.2§	94.4	0.85	0.76	1.46	–	0.72	− 0.7
Luxembourg	− 4.4	Aug	+ 3.5	Q2	na	na	104.5§	104.6	0.85	0.76	1.46	–	0.72	− 0.8
New Zealand	− 4.1	Sep	− 8.2	Q2	na	na	140.6	132.4	1.44	1.41	2.48	1.70	1.21	+ 3.2
Norway	+ 45.9	Oct	+ 40.8	Q2	na	na	111.1	107.5	6.68	6.18	11.5	7.88	5.63	+ 14.4
Portugal	− 14.2	Aug	− 16.6	Sep	na	na	93.7**	93.6	0.85	0.76	1.46	–	0.72	− 5.3

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, September average. ‡OECD forecast. **IMF, July average.

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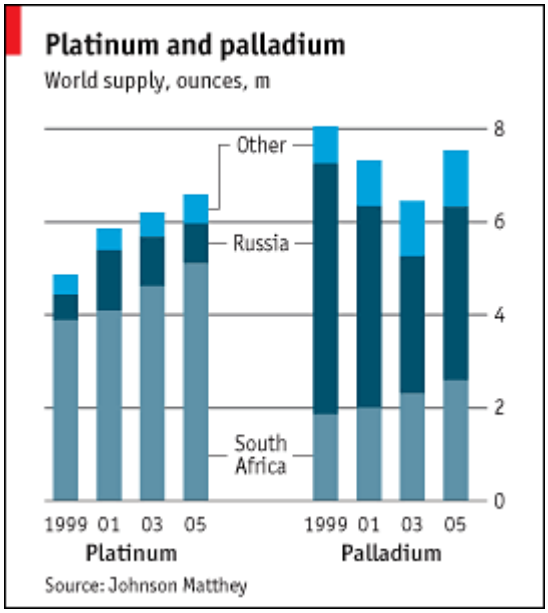
Platinum and palladium

Nov 24th 2005
From The Economist print edition

The growth in platinum supplies has failed to keep pace with demand this year and stocks are forecast to fall for the seventh year running. Palladium supplies will fall by 5%; Russia will sell less metal.



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Overview

Nov 24th 2005
From The Economist print edition

Hong Kong's rate of consumer-price inflation rose to 1.8% in the 12 months to October, its highest for more than seven years. **Singapore's** inflation rate rose to 1.1% in the same month.

Venezuela's GDP growth slowed to 9.8% in the year to the third quarter, but that was still the second-fastest growth, after Argentina, of the countries in the table. **Indonesia's** GDP grew by 5.3% over the same period.

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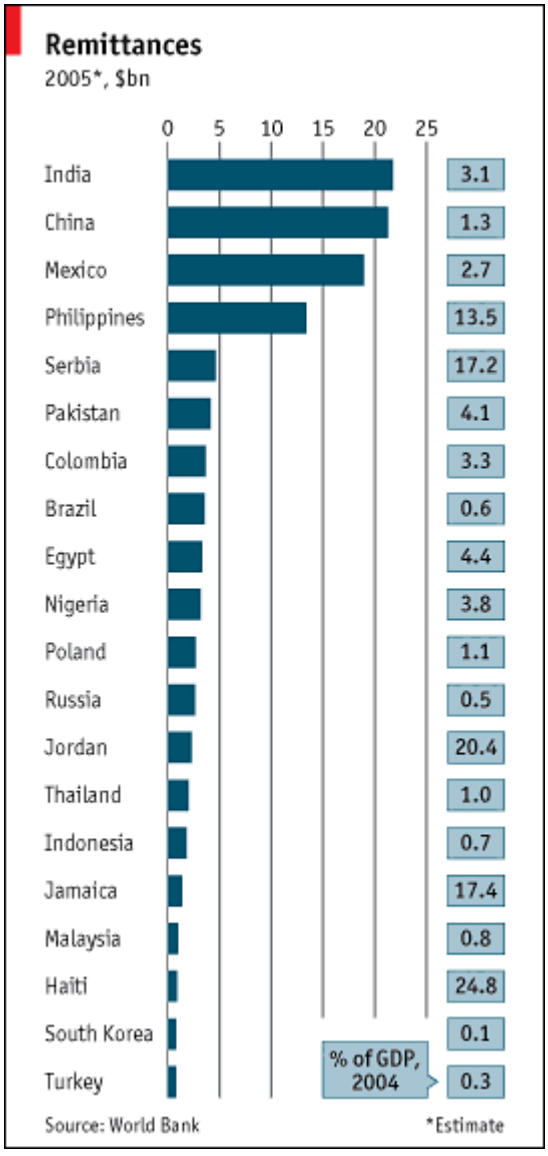
Remittances

Nov 24th 2005
From The Economist print edition

Immigrants from poor countries are expected to send more than $167 billion back home this year, according to a World Bank report. This total is on a par with the amount of foreign direct investment in developing countries and more than twice the value of foreign aid. What is more, the report reckons that money sent through informal channels could add 50% to this estimate. About 30-45% of remittances to poor countries comes from other parts of the developing world, such as Malaysia and South Africa. Remittances are not as fickle as other sources of foreign exchange, and may increase in response to natural disasters. But they are not spread evenly. India alone will receive $21.7 billion this year, up from $13 billion in 2001.



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Economy

Nov 24th 2005
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.4	Q3	+16.1	Oct	+ 1.2	Oct	+101.5	Oct	+68.7	2004	769.0	Sep
Hong Kong	+ 6.8	Q2	– 0.1	Q2	+ 1.8	Oct	– 9.5	Sep	+21.3	Q2	121.9	Oct
India	+ 8.1	Q2	+ 7.3	Sep	+ 3.6	Sep	–36.5	Oct	–16.0	Q2	137.6	Oct
Indonesia	+ 5.3	Q3	– 3.4	Sep	+17.9	Oct	+26.7	Sep	+ 4.0	Q2	30.2	Sep
Malaysia	+ 4.1	Q2	+ 4.9	Sep	+ 3.3	Oct	+24.4	Sep	+18.0	Q2	79.7	Sep
Philippines	+ 4.8	Q2	+ 7.3	Aug	+ 7.0	Oct	– 1.3	Aug	+ 3.2	Jun	15.6	Oct
Singapore	+ 6.0	Q3	+21.1	Sep	+ 1.1	Oct	+16.4	Oct	+33.7	Q3	115.6	Oct
South Korea	+ 4.4	Q3	+ 7.2	Sep	+ 2.5	Oct	+25.8	Oct	+18.6	Sep	207.2	Oct
Taiwan	+ 4.4	Q3	+ 9.3	Oct	+ 2.6	Oct	+ 2.9	Oct	+ 8.9	Q3	252.0	Oct
Thailand	+ 4.4	Q2	+ 4.8	Sep	+ 6.2	Oct	– 6.9	Sep	– 2.0	Sep	48.5	Sep
Argentina	+10.1	Q2	+ 6.8	Sep	+10.7	Oct	+11.4	Sep	+ 2.9	Q2	24.8	Sep
Brazil	+ 3.9	Q2	+ 0.2	Sep	+ 6.4	Oct	+41.9	Oct	+13.1	Sep	56.5	Sep
Chile	+ 6.5	Q2	+ 5.8	Sep	+ 4.1	Oct	+ 8.7	Oct	– 0.2	Q3	15.0	Oct
Colombia	+ 5.3	Q2	+ 5.7	Aug	+ 5.3	Oct	+ 1.6	Aug	– 0.8	Q2	14.1	Oct
Mexico	+ 3.3	Q3	+ 1.0	Sep	+ 3.1	Oct	– 9.5	Oct	– 8.4	Q2	69.9	Sep
Peru	+ 5.7	Sep	+ 6.0	Sep	+ 1.3	Oct	+ 4.3	Sep	+ 0.4	Q2	12.7	Oct
Venezuela	+ 9.8	Q3	+12.4	Sep	+16.0	Oct	+28.2	Q3	+21.6	Q3	26.4	Aug
Egypt	+ 5.2	Q1	+ 3.3	2004†	+ 3.7	Sep	–10.4	Q2	+ 2.9	Q2	19.8	Sep
Israel	+ 5.7	Q3	+12.1	Sep	+ 2.7	Oct	– 8.3	Sep	+ 1.3	Q2	28.4	Oct
South Africa	+ 4.5	Q2	+ 5.9	Sep	+ 4.0	Oct	– 3.0	Sep	– 8.6	Q2	17.8	Oct
Czech Republic	+ 5.1	Q2	+ 7.1	Sep	+ 2.6	Oct	+ 1.5	Sep	– 4.1	Q2	29.4	Oct
Hungary	+ 4.6	Q3	+ 8.9	Sep	+ 3.2	Oct	– 3.4	Sep	– 8.6	Q2	17.5	Oct
Poland	+ 2.8	Q2	+ 7.6	Oct	+ 1.6	Oct	– 3.2	Sep	– 4.8	Sep	40.1	Oct
Russia	+ 6.1	Q2	+ 3.5	Oct	+11.8	Oct	+117.0	Sep	+78.3	Q2	161.2	Oct
Turkey	+ 4.2	Q2	+ 9.3	Sep	+ 7.5	Oct	–41.2	Sep	–21.4	Sep	41.8	Sep
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 9.9	Q2	+12.8	Sep	+ 4.5	Oct	– 2.4	Aug	– 1.5	Sep	1.7	Sep
Latvia	+11.6	Q2	+ 7.8	Sep	+ 7.6	Oct	– 2.8	Sep	– 1.6	Sep	2.3	Sep
Lithuania	+ 7.6	Q3	na		+ 2.9	Oct	– 3.4	Sep	– 1.5	Sep	3.6	Sep
Slovakia	+ 5.1	Q2	+ 5.4	Sep	+ 3.3	Oct	– 1.9	Sep	– 2.4	Jul	15.3	Sep
Slovenia	+ 5.2	Q2	+ 2.0	Sep	+ 3.1	Oct	– 1.4	Sep	– 0.3	Sep	8.1	Aug
Pakistan	+ 8.4	2005†	+13.6	Apr	+ 8.3	Oct	– 8.3	Oct	– 1.5	Q2	10.2	Sep
Saudi Arabia	+ 6.2	2005	na		+ 0.4	Aug	+85.2	2004	+51.5	2004	23.2	Sep

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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Financial markets

Nov 24th 2005
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Nov 23rd		Dec 31st 2004	
	Nov 23rd	year ago	Nov 23rd	% a year		one week	in local currency	in $ terms
China	8.08	8.28	13.9	1.80	1,162.1	+0.9	- 12.6	- 10.5
Hong Kong	7.75	7.77	13.3	4.19	15,062.4	+2.8	+ 5.8	+ 6.1
India	45.7	45.0	78.7	5.80	8,638.3	+0.5	+ 30.8	+ 24.4
Indonesia	10,053	8,975	17,305	14.53	1,061.1	+3.4	+ 6.1	- 2.0
Malaysia	3.78	3.80	6.50	2.94	902.9	+0.7	- 0.5	+ 0.1
Philippines	54.2	56.3	93.4	7.88	2,103.8	+2.1	+ 15.4	+ 19.4
Singapore	1.69	1.64	2.91	3.09	2,296.5	+1.9	+ 11.2	+ 7.2
South Korea	1,036	1,067	1,783	3.96	1,282.0	+1.2	+ 43.1	+ 43.1
Taiwan	33.5	32.3	57.6	1.55	6,123.5	+1.3	- 0.3	- 5.6
Thailand	41.2	39.7	70.9	4.35	669.2	-0.9	+ 0.2	- 5.5
Argentina	2.95	2.94	5.07	7.56	1,627.4	+2.7	+ 18.3	+ 19.4
Brazil	2.24	2.74	3.85	18.98	31,942.6	+4.8	+ 21.9	+ 44.9
Chile	525	588	904	4.92	9,570.4	+0.5	+ 6.8	+ 13.0
Colombia	2,279	2,503	3,924	6.44	8,452.4	+4.9	+ 94.5	+100.7
Mexico	10.6	11.3	18.3	8.61	16,713.9	+2.5	+ 29.4	+ 35.8
Peru	3.39	3.31	5.83	3.00	4,970.8	-1.4	+ 34.0	+ 29.6
Venezuela	2,479§	2,503§	4,268	11.40	20,465.2	+2.2	- 31.7	- 28.9
Egypt	5.76	6.25	9.92	9.23	48,661.3	-3.4	+ 97.9	+108.6
Israel	4.71	4.37	8.12	4.56	774.4	+2.8	+ 20.3	+ 10.2
South Africa	6.54	5.94	11.3	7.30	17,236.0	+0.6	+ 36.2	+ 17.3
Czech Republic	24.8	23.6	42.6	2.26	1,396.0	+1.2	+ 35.3	+ 22.0
Hungary	214	186	369	6.37	20,773.6	-0.7	+ 40.9	+ 18.9
Poland	3.33	3.20	5.73	4.62	33,275.0	+0.8	+ 24.9	+ 12.3
Russia	28.8	28.4	49.5	13.00	1,017.2‡	+2.8	+ 71.8	+ 65.6
Turkey	1.36	1.43	2.34	15.18	36,179.3	+3.8	+ 44.9	+ 43.7
EM (MSCI)*	1.00	1.00	1.72	na	664.0	+2.4	+ 22.5	+ 22.5
EMBI+†	1.00	1.00	1.72	na	362.5	+0.9	+ 10.0	+ 10.0

*Emerging Mkts. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

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